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Is Chapter 11 Bankrupt?

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IS CHAPTER 11 BANKRUPT?

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Abstract: This Article discusses the continuing contraction of business reorganization under the Bankruptcy Code. It argues that it is wrong to assume that there is no need for a business reorganization law in a modern, service-oriented economy that has well-developed capital markets. The Article first analyzes and contrasts bankruptcy law in the United States under the Chandler Act of 1938, which fostered the concept of reorganization and rehabilitation of distressed business entities, and under the Bankruptcy Reform Act of 1978, which built upon lessons learned under the Chandler Act and pursuant to which bankruptcy reorganization became an appropriate and necessary vehicle to preserve and protect the values of major business organizations. The Article then traces the economic, legal, political, and ideological changes that threaten the viability of corporate rehabilitation, including the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Finally, this Article responds directly to anti-Chapter 11 theorists, arguing: (1) reorganization remains relevant to preserving going-concern values in today's economy, (2) Chapter 11 has significant value as a transparent, neutral, multi-party forum to address the insolvency of a business, even when a marketplace exists for the debtor's assets, and (3) the privatization of the insolvency process is both unworkable and undesirable.

INTRODUCTION

The concept of debtor reorganization and rehabilitation is in peril. The marvel of modern reorganizations of financially distressed businesses that was ignited by the railroad equity receiverships of the nineteenth century and codified by twentieth-century legislation is fading. As the twenty-first century progresses, the use of Chapter 11 of

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the Bankruptcy Code[1] as a primary reorganization and rehabilitation tool for businesses is under relentless attack—an attack led by those who want to revert back to strict enforcement of contracts and the primacy of creditor rights. Fundamental changes in the economy, accompanied by a shifting and more conservative intellectual approach, are now leading to cries that Chapter 11 is obsolete and irrelevant in a modern economy.

The concept of an even-handed process to deal with financial distress, insolvency, and the interests of all involved parties, although only almost a century old in its modern form in the United States, has a history that goes back to biblical times. It has been subject to constant revision to reflect shifting societal goals, the consequences of failure, and the perception of the debtor as a real party in interest. Thus, the innovative use of equity receiverships to reorganize railroads that created the paradigm for modern reorganization principles occurred during the Industrial Revolution, a period when rapid industrialization caused significant social and economic upheaval as the United States transformed from an agrarian to a manufacturing and industrial economy. The preservation of going-concern values and jobs became more important than the enforcement of contractual rights and the liquidation and dismemberment of a debtor's assets to benefit particular creditors.

Today, Chapter 11 critics can point to recent statistics to bolster their argument that Chapter 11 has outlived its usefulness. During the ten-year period from 1994 to 2003, the total number of bankruptcy cases filed increased by an average of 8.53% per year.[2] Yet, during the same period, the number of Chapter 11 cases filed decreased by an average of 4.13% per year.[3] From a different perspective, in 1994, 1.77% of total bankruptcy cases filed were Chapter 11 cases.[4] In 2003, the percentage dropped to 0.57%.[5] These statistics raise the question whether there is a growing recognition that Chapter 11 is losing its attraction as

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[1] The current law of bankruptcy is found in Title 11 of the United States Code. *See* 11 U.S.C. §§ 101 *et seq.* (2000). Its foundation is the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (effective Oct. 1, 1979) (codified as amended at 11 U.S.C. §§ 101 *et seq.* (2000)). The Bankruptcy Reform Act of 1978 is typically referred to as the "Bankruptcy Code" or the "Code." References in this work to the "Bankruptcy Code" or the "Code" are to Title 11 of the United States Code.

[2] 2004 Bankruptcy Yearbook & Almanac 5 (Christopher M. McHugh & Thomas A. Sawyer eds., 2004) [hereinafter *Bankruptcy Yearbook*].

[3] *Id.*

[4] *Id.*

[5] *Id.*

a process to rehabilitate and resuscitate a distressed business entity.[6] The qualitative statistics are also revealing. Professor Lynn M. LoPucki has reported that, between 1982 and 1990, over 80% of Chapter 11 cases resulted in reorganizations.[7] A downward trend began in 1996, when this statistic fell to 63%, and, for 2000 and 2002, to 51%.[8] Professors Douglas G. Baird and Robert K. Rasmussen have concluded: "Corporate reorganizations have all but disappeared. Giant corporations make headlines when they file for Chapter 11, but they are no longer using it to rescue a firm from imminent failure. Many use Chapter 11 merely to sell their assets and divide up the proceeds."[9]

Has the structure of our economy changed so fundamentally that the concept of bankruptcy reorganization as we know it has ceased to be relevant? If not, what explains these statistics? To address these questions properly, one must review the history and development of bankruptcy law and reorganization in America and the modern developments in the Chapter 11 arena. Part I of this Article traces the historical roots of bankruptcy law in America since the Great Depression—the catalyst for the Chandler Act, which represented the first lasting codification of national bankruptcy reorganization law intended to deal with the failure of large businesses.[10] Part II analyzes the passage of the Bankruptcy Reform Act of 1978, emphasizing the legislative goal of encouraging debtor rehabilitation.[11] Part III assesses today's changing economy and other modern developments affecting business reorganizations.[12] Part IV analyzes the implications of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[13] Finally, Part V of this Article addresses the points raised by the anti-Chapter 11 theorists and highlights the current issues affecting the viability of bankruptcy reorganization today.[14]

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[6] *See id.*

[7] Francoise C. Arsenault, *Going, Going Gone—Upward Trend in Section 363 Sales*, TURNAROUNDS & WORKOUTS, Dec. 15, 2004, at 4.

[8] *Id.*

[9] Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 751 (2002).

[10] *See infra* notes 15–78 and accompanying text.

[11] *See infra* notes 79–139 and accompanying text.

[12] *See infra* notes 140–90 and accompanying text.

[13] *See infra* notes 191–227 and accompanying text.

[14] *See infra* notes 228–87 and accompanying text.

I. The State of Bankruptcy Law Before the Bankruptcy Reform Act of 1978

Credit is an integral part of the economic security and well-being of our society.[15] Insolvency laws that provide a level of certainty with respect to the treatment of debtors and creditors when dealing with inevitable failures or defaults of businesses are critical to instilling confidence and encouraging the extension and use of credit in our society.

The need for such laws was recognized early in the nation's history. Thus, it was contemplated that the protection of debtors' rights and the exercise of creditors' rights would be established through the enactment of a uniform national bankruptcy law. Article I, section 8, clause 4 of the U.S. Constitution provides Congress with the power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."[16] James Madison pronounced, "[t]he power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question."[17]

Notwithstanding the constitutional authority to enact national bankruptcy laws, the road to lasting federal bankruptcy legislation was a bumpy, intermittent one. Congress rarely reached consensus throughout the late eighteenth and nineteenth centuries as to bankruptcy legislation. Southern agricultural states, suspicious of northern Federalist ideals, were opposed to a national bankruptcy law that would govern the appropriation of real and personal property by operation of law to satisfy creditor claims.[18] In contrast, Northerners favoring a strong central government supported bankruptcy legislation as necessary to promote commercial enterprise, to encourage the extension of credit, and to protect creditors and personal liberties.[19]

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[15] *Fair and Accurate Credit Transactions Act of 2003: Hearing on H.R. 2622 Before the H. Comm. on Financial Services*, 108th Cong. 9, 12 (2003) (testimony of John W. Snow, Treasury Secretary), *available at* http://financialservices.house.gov/media/pdf/108-47.pdf.

[16] U.S. Const. art. I, § 8, cl. 4.

[17] The Federalist No. 42, at 271 (James Madison) (Clinton Rossiter ed., 1961).

[18] *See* David A. Skeel, Jr., Debt's Dominion: A History of Bankruptcy Law in America 26 (2001).

[19] *See* Ron Chernow, Alexander Hamilton 308, 326 (2004); Skeel, *supra* note 18, at 26; James A. McLaughlin, *Book Review*, 49 Harv. L. Rev. 861, 862, 864 (1936) (reviewing Charles Warren, Bankruptcy in United States History (1935)).

Consequently, the evolution of bankruptcy law has been the product of distrust of federal courts and the economic "bust-and-boom" cycle.[20] Periods of economic downturn resulted in calls for bankruptcy legislation and relief, while periods of recovery resulted in the repeal of such legislation prior to the twentieth century.[21] The Great Depression of the 1930s was the catalyst for the passage of the Chandler Act of 1938 (the "Chandler Act"), which amended the Bankruptcy Act of 1898 and provided for a lasting codification of the bankruptcy reorganization principles that had evolved during the equity receivership reorganizations of railroads.[22]

A. *Passage of the Chandler Act of 1938*

During the "Roaring Twenties," there was a widespread belief that a booming economy and heightened living standards would continue to increase indefinitely. When the world monetary system collapsed and a general panic among bankers and businesses ensued with the onslaught of the Great Depression, the viability of the economy came into question. Popular mistrust and hostility toward the business barons of Wall Street grew exponentially. These pressures first provided the catalyst for the reform and government intervention that ultimately resulted in the New Deal and then shaped the resulting legislation to deal with the economic depression.

On October 29, 1929, the stock market crashed, resulting in the loss of $10 billion to $15 billion of market value in one day. Declining prices and falling production ensued, and unemployment increased at a drastic rate. The United States and other nations fell deeper and deeper into the Great Depression, widely considered to be the worst and longest economic collapse in the history of the modern industrial world. Workers were unemployed because companies would not hire them, and companies would not hire employees because there was no market for goods as workers did not have income to purchase goods. In 1933, at the nadir of the Great Depression, over fifteen million Ameri-

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[20] SKEEL, *supra* note 18, at 24–25 (noting that this traditional account, while inaccurate in some respects, is a convenient framework for describing the first century of bankruptcy debate).

[21] *Id.*

[22] Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 166–67 (2004) (citations omitted). For a detailed discussion of the history of bankruptcy law prior to the passage of the Chandler Act and the historical treatment of the "hapless debtor," see *id.* at 153–66.

cans—one quarter of the nation's workforce—were unemployed, and shares of equity interests maintained only 20% of their pre-crash value.[23]

Just as economic panics before have spawned national legislation, the Great Depression caused the nation to consider remedial bankruptcy legislation. The survival of distressed businesses and their related employment opportunities became a major objective of Congress. Initially, during the early 1930s, emergency legislation was enacted to provide an alternative to liquidation of distressed business entities under the protection of the district courts sitting as bankruptcy courts (for example, sections 77 and 77b of the Bankruptcy Act of 1898).[24] The emergency legislation, intended to enable the reorganization of business entities, was followed by the realization that a more comprehensive statutory scheme was necessary to meet the economic crisis of the Great Depression.[25]

Guidance came from the experiences of the railroad equity receiverships. The railroad equity receivership was a business structure fashioned to meet the crisis resulting from the widespread failure of the railroad industry after the Civil War.[26] As David Skeel has noted, "[b]etween 1873 and the end of the nineteenth century, roughly one-third of all the railroads—some seven hundred in all—failed, and in some years nearly 20% of the nation's track was in receivership."[27] Railroads, the construction of which were heavily subsidized by the federal government, were seen as a central part of a new national economy because of their ability to move goods and people over long distances within a short period of time. By their nature, the assets of a railroad crossed multiple state lines. Consequently, in the event of default, the railroad faced the threat of individual creditors obtaining state court judgments and causing the dismemberment of the railroad's assets to satisfy such judgments. Many of the fledgling railroads were net consumers of cash and undercapitalized. Similar to the contemporary failures involving telecom companies, the railroad promoters underestimated the cost of construction, geographical obsta-

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[23] *See generally* J. Bradford DeLong, The Economic History of the Twentieth Century: Slouching Towards Utopia? (Mar. 1, 1997) (unpublished manuscript, University of California at Berkeley and National Bureau of Economic Research), *available at* http://www.j-bradford-delong.net/TCEH/Slouch_title.html.

[24] *See* SKEEL, *supra* note 18, at 73–74.

[25] *See id.* at 74.

[26] *Id.* at 48–70.

[27] *Id.* at 51–52.

cles, and the time of construction and completion, and overestimated the projected volume of passenger and freight traffic. The result was liquidity deficiencies and defaults in their respective obligations.

In response to the threat that the railroads would cease operations, and drawing upon their equitable authority to appoint receivers to administer properties when appropriate, progressive federal district courts forged the concept of using equity receiverships to assume control of a defaulting railroad and its assets.[28] The federal railroad equity receivership negated state borders and provided a single forum to protect and administer the assets of the distressed railroad. The process involved the debtor railroad, the significant creditors, and the federal district court working together to effectuate the continuation of the railroad in the public interest.[29] At the same time, the affected parties in interest, through the use of protective committees and receivers appointed by the federal court, negotiated the reorganization and recapitalization of the railroad.[30]

The process generally began with the filing of a "creditor's bill," which formally asked the court to appoint a receiver, a judicially appointed person entrusted with receiving and preserving property subject to a judicial proceeding.[31] The filing of a creditor's bill acted as a modern-day "automatic stay."[32] The process followed with the technical filing of a "foreclosure bill," which asked the court to schedule a sale of the property.[33] The debtor railroad did not contest the bills and usually consented to the relief requested.[34] Multiple protective committees of bondholders and stockholders would be formed to represent respective stakeholders in the bargaining process, and negotiations to restructure the railroad's financial affairs would ensue.[35] The negotiations would culminate in a reorganization plan that would recapitalize the railroad as a new entity and distribute new securities to the stockholders pursuant to the plan.[36]

Two central modern bankruptcy concepts emerged from the railroad receivership paradigm: (1) the notion of preserving going-concern value for economic stakeholders by allowing the debtor's op-

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[28] *See id.* at 57.

[29] SKEEL, *supra* note 18, at 57.

[30] *Id.* at 57–59.

[31] *Id.* at 58.

[32] *Id.*

[33] *Id.*

[34] SKEEL, *supra* note 18, at 58.

[35] *Id.* at 58–59.

[36] *Id.* at 57–59.

erations to continue as an ongoing business, and (2) the retention and active participation of the railroad's management in the operations of the railroad and the development of a business plan to support a reorganization. Prior to the railroad failures, receiverships were traditionally viewed as an extreme remedy that contemplated "the absolute wresting away from the hands of its owners of property of such peculiar character, and often of such enormous value."[37] Instead of adopting this traditional view, federal courts in the railroad receivership era reacted to the necessity of preserving value and serving the public interest and crafted novel ideas that served as the paradigm for modern reorganizations.[38] Creditors and courts embraced the concept that the debtor's (i.e., existing management's) knowledge, expertise, and familiarity with its business were inherently valuable in large, complex, corporate restructurings.[39] The participation of the debtor in the railroad equity receiverships became nearly indispensable.[40]

This debtor-in-possession concept was memorialized in 1884 with Wabash, St. Louis, and Pacific Railway ("Wabash"), which was one of the first voluntary equity receiverships and one of the most celebrated.[41] Until Wabash, receivership had been purely a creditors' remedy, initiated only after a creditor's request and a foreclosure action against collateral security by one or more classes of creditors.[42] In the case of Wabash, representatives of the railroad (Wall Street investors) *themselves* sought and obtained judicial authority to commence a receivership and to be appointed as the receivers, in an effort to continue to operate and manage the railroad *prior* to the railroad defaulting in the payment of interest.[43] As Skeel observed, "Wabash was . . . the most vivid illustration of the fact that managers and their Wall Street professionals, not ordinary creditors, were the ones who controlled the reorganization process."[44]

The railroad receivership courts afforded railroad managers, investment bankers, and reorganization lawyers substantial leeway in

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[37] D.H. Chamberlain, *New-Fashioned Receiverships*, 10 HARV. L. REV. 139, 141 (1896).

[38] SKEEL, *supra* note 18, at 57.

[39] *See* Harvey R. Miller & Erica M. Ryland, *The Role of Mega Cases in the Development of Bankruptcy Law*, *in* THE DEVELOPMENT OF BANKRUPTCY & REORGANIZATION LAW IN THE COURTS OF THE SECOND CIRCUIT OF THE UNITED STATES 189, 210 (1995).

[40] *See* Chamberlain, *supra* note 37, at 140.

[41] Albro Martin, *Railroads and the Equity Receivership: An Essay on Institutional Change*, 34 J. ECON. HIST. 685, 697–701 (1974).

[42] SKEEL, *supra* note 18, at 64.

[43] *Id.*

[44] *Id.*

their prosecution of the cases. Managers would oversee the business operations, while the bankers and attorneys would negotiate the reorganization with the creditor constituencies through the device of protective committees. Cognizant of the expanding power the investment bankers and lawyers exercised as they became more efficient at the receivership process, courts alluded to the ideological consensus in favor of reorganizing troubled railroads—that railroads served the public interest and should not be allowed to fail—and hinted that such leniency would not be afforded to the reorganization of other types of entities.[45]

The equity receivership process, however, was not without its detractors. Critics complained that bankers would routinely allocate themselves generous underwriting fees upon the issuance of new securities as part of the reorganization plan, and attorneys and other professionals would receive very substantial fees with minimal oversight before anyone else in the case was paid.[46] Moreover, critics contended that attorneys were often compromised by their relationship with managers and looked the other way in the presence of fraud or mismanagement.[47]

As the Great Depression continued, Congress considered legislative action to preserve the nation's industrial and commercial base. The newly formed Securities and Exchange Commission (the "SEC") commissioned a study to review the use of federal consent receiverships to reorganize distressed business and to develop a legislative proposal in connection therewith.[48] The result was the enactment of the Chandler Act.[49] It codified the principles developed in railroad reorganization cases as the basis for rehabilitating and reorganizing distressed businesses.[50] It provided for a single, nationwide forum to deal with business failures and the interests of the economic stakeholders.[51] The Chandler Act encompassed the proposals of the SEC based upon its study of federal consent receivership cases and the use of protective committees by enacting Chapter X of the Bankruptcy Act, entitled "Corporate Reorganizations."[52] Chapter X was intended to provide the

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[45] *See* Shapiro v. Wilgus, 287 U.S. 348, 356 (1932); Harkin v. Brundage, 276 U.S. 36, 52 (1928); SKEEL, *supra* note 18, at 105.

[46] *See* SKEEL, *supra* note 18, at 110–11.

[47] *See id.*

[48] Miller & Ryland, *supra* note 39, at 211.

[49] *See generally* Act of June 22, 1938, ch. 575, 52 Stat. 840 (1938), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549.

[50] *See id.*; Miller & Ryland, *supra* note 39, at 213–14.

[51] *See* Act of June 22, 1938, ch. 575, 52 Stat. at 840.

[52] *Id.* at 883; Miller & Ryland, *supra* note 39, at 213–14.

vehicle for the reorganization of large, publicly owned corporations, and to avoid the evils that had been associated with the Wall Street-controlled equity receiverships and that had been uncovered by the SEC study.[53] In addition, the Chandler Act included the enactment of Chapter XI—"Arrangements"—of the Bankruptcy Act.[54] Chapter XI, intended to deal only with unsecured credit of smaller debtors, endorsed the concept of a debtor-in-possession, in lieu of a receiver or a trustee, to administer the debtor's estate during the Chapter XI process.[55] The Chandler Act drew on both the populist mistrust of the Wall Street community and attorneys who controlled many of the receivership cases of the nineteenth and twentieth centuries and the populist sentiment associated with the New Deal reform legislation endorsed by substantial Democratic majorities in the House of Representatives and the Senate.[56]

B. *Chapter X*

Chapter X provided the statutory framework for a comprehensive reorganization of a financially distressed corporation. It was intended to deal with all aspects of the corporation's business and capital structure. Under Chapter X, relief was available both on a voluntary and involuntary basis. Because Chapter X was intended to deal with large publicly owned corporations, it provided that the administration of a Chapter X case, in large measure, would be under the direct supervision of a U.S. district court judge rather than a referee in bankruptcy.[57] It provided for (a) the mandatory appointment of one or more trustees in reorganization, if the liabilities of the corporation exceeded $250,000; (b) the appointment of an "examiner" if no trustee was mandated; (c) the strict application of the fair and equitable (absolute priority) rule that required an elaborate process to determine the enterprise value of the debtor's business; (d) the ability to impair the rights of secured and unsecured creditors, as well as equity-interest holders; (e) the availability of the "cram down" power to confirm a plan of reorganization over dissenting classes of creditors or equity-interest holders; (f) a statutory and extensive role for the

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[53] Miller & Ryland, *supra* note 39, at 214.

[54] Act of June 22, 1938, ch. 575, 52 Stat. at 905.

[55] Miller & Ryland, *supra* note 39, at 214.

[56] *See* Skeel, *supra* note 18, at 119–21. *See generally* Act of June 22, 1938, ch. 575, 52 Stat. 840 (1938), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549.

[57] Jeb Barnes, *Bankrupt Bargain? Bankruptcy Reform and the Politics of Adversarial Legalism*, 13 J.L. & Pol. 893, 907 n.72 (1997).

SEC; (g) an extended process for the development and proposal of a plan of reorganization; (h) a first right on the part of the reorganization trustee to propose a plan of reorganization; (i) a requirement that the district court determine that a proposed plan was worthy of consideration before solicitation of acceptances could proceed; (j) no statutory committees of creditors or equity-interest holders; and (k) a broad comprehensive discharge.[58]

In answer to the perceived corruption that occurred in some of the equity receivership reorganization cases and its effect on the operation of protective committees that had been uncovered by the SEC study, Chapter X introduced the principle of disinterestedness.[59] Reorganization fiduciaries such as trustees and appointed professionals were required to document their disinterestedness as a condition to employment and by implication, to allowances and the payment of compensation.[60] Management and, in effect, the board of directors were displaced by the mandatory appointment of a reorganization trustee, and there was a significant loss of control by traditional power groups.[61] Skeel characterized this power shift as follows: "Out were private negotiation and the wiles of Wall Street, in was pervasive governmental oversight."[62] The SEC rigidly exercised oversight as to the requirement of disinterestedness.[63] As a result of the extensive statutory provisions and prerequisites to the proposal of a plan of reorganization, its acceptance, and ultimately, its consummation, Chapter X cases extended over a long period of time.[64] The combination of the above factors had the effect of discouraging corporations from entering into Chapter X cases.

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[58] *See* Chandler Act of 1938, Pub. L. No. 75-696, §§ 167–68, 52 Stat. 840, 890, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549; SKEEL, *supra* note 18, at 119–27; Miller & Waisman, *supra* note 22, at 169–70.

[59] *See* Miller & Waisman, *supra* note 22, at 169–70.

[60] *Id.* at 169.

[61] *See id.*; *see also* SKEEL, *supra* note 18, at 119–20 ("The act gave the trustee explicit authority to take over the business activities of the bankrupt firm; and the new law took the power to formulate a reorganization plan out of the hands of the creditors and vested it in the trustee. Creditors and other parties could, in theory, make suggestions to the trustee; but the trustee, and the trustee alone, was the one who would develop the terms of any reorganization.") (citation omitted).

[62] *See* SKEEL, *supra* note 18, at 122.

[63] *Id.*

[64] *Id.* at 171 ("The effect of SEC's tardiness was to exacerbate the delay that already characterized cases that were handled in Chapter X. This made Chapter XI look even better to bankruptcy lawyers and the bankruptcy court."); Harvey R. Miller & Alan N. Resnick, *Commentary on Professor Warren's Paper: Absolute Priority*, 1991 ANN. SURV. AM. L. 49, 50 (1992).

Management, fearful of being displaced, would delay the commencement of bankruptcy cases.[65] Often, during this process, the deterioration of the debtor's business would continue unabated and sometimes result in the loss of the ability to reorganize and rehabilitate. In 1938, more than 500 corporations commenced cases under Chapter X.[66] By 1944, that number had dropped to sixty-eight.[67] During the 1950s and 1960s, the number of Chapter X cases each year fluctuated around one hundred.[68] The effect of the rigid requirements of Chapter X encouraged distressed business corporations and their professionals to consider the availability of relief under Chapter XI of the Chandler Act. Chapter XI did not mandate the appointment of a reorganization trustee and often permitted the debtor's management to stay in control of the affairs of the debtor as a debtor-in-possession.[69] In Chapter XI cases, equity-interest holders often were able to retain their interests.[70] In addition, Chapter XI provided no statutory role for the SEC.[71]

C. *Chapter XI*

As the economy of the United States expanded following the Second World War and credit became more accessible, the occurrence of bankruptcy filings increased.[72] Given the unattractiveness of Chapter X, those experiencing credit defaults explored the possibility of resorting to relief under Chapter XI of the Chandler Act. Chapter XI contemplated a plan to arrange the debtor's unsecured debts and liabilities in an attempt to enable the debtor to satisfy those obligations. It did not necessarily displace management.[73] Most importantly, debtors had a virtually unlimited exclusive right to file a plan of arrangement.[74] The alternative to a plan of arrangement was liquidation with potentially significant loss of value. This power acted as a de facto "cram down" and was used by debtors and their professionals to drive the terms of a plan of arrangement or to extend the term of a Chapter XI case. In addition, the "fair and equitable" rule that had origi-

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[65] *See* Miller & Waisman, *supra* note 22, at 169–70.

[66] SKEEL, *supra* note 18, at 125.

[67] *Id.*

[68] *Id.*

[69] *Id.*

[70] *Id.* at 125–27.

[71] SKEEL, *supra* note 18, at 125–27.

[72] Jagdeep S. Bhandari & Lawrence A. Weiss, *The Increasing Bankruptcy Filing Rate: An Historical Analysis*, 67 AM. BANKR. L.J. 1, 1 (1993).

[73] SKEEL, *supra* note 18, at 125–27, 161–63.

[74] *See id.* at 163.

nally been a part of Chapter XI was repealed in 1952.[75] As a consequence, a plan of arrangement could provide for equity-interest holders to retain their interests despite a less-than-full recovery by creditors.

Chapter XI was designed to provide an efficient, expeditious, and economical vehicle for a small, generally privately owned business enterprise or an individual that desired to modify and discharge unsecured debts.[76] It did not provide any specific authority to effectuate the rights of secured creditors or, theoretically, equity-interest holders.

As distressed business corporations and their professionals sought to avoid Chapter X, they explored and pursued means to expand the scope of Chapter XI to reorganize and rehabilitate the corporations' business. The SEC zealously fought the use of Chapter XI for publicly owned corporations, to protect, first, public stockholders and, thereafter, public bondholders. The Supreme Court, however, held that publicly owned corporations could use Chapter XI for the purpose of reorganization if that form of bankruptcy served the "needs" of the corporation.[77] The creativity and ingenuity developed in connection with the application of the provisions of Chapter XI to large, complex business entities had the effect of transforming Chapter XI from a debtor-relief chapter intended for small "mom and pop" businesses with small amounts of unsecured liabilities, to a reorganization vehicle used by Fortune 500 corporations.[78]

II. The Bankruptcy Reform Act of 1978 and the Emphasis on Rehabilitation

The Bankruptcy Reform Act of 1978 (the "1978 Act"), which enacted the current Bankruptcy Code, was signed by President Jimmy Carter on November 6, 1978 and took effect on October 1, 1979.[79] The 1978 Act was both the first bankruptcy legislation not enacted on the

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[75] *Id.* at 124, 167.

[76] *Id.* at 125–27.

[77] *See* Gen. Stores Corp. v. Shlensky, 350 U.S. 462, 466 (1956) ("A large company with publicly held securities may have as much need for a simple composition of unsecured debts as a smaller company. And there is no reason we can see why c. XI may not serve that end. The essential difference is not between the small company and the large company but between the needs to be served.").

[78] *See* Skeel, *supra* note 18, at 127.

[79] Pub. L. No. 95-598, 92 Stat. 2549 (1978) (effective Oct. 1, 1979) (codified as amended at 11 U.S.C. §§ 101 *et seq.* (2000)).

heels of domestic economic turmoil[80] and the first comprehensive reform of federal bankruptcy law since the passage of the Chandler Act. A decade in the making, the final version of the 1978 Act was the culmination of separate drafting efforts by a congressional commission, the House of Representatives, the U.S. Senate, and the National Association of Bankruptcy Judges. A primary catalyst for this flurry of activity to revamp bankruptcy law was a 1971 study conducted by the Brookings Institution, which called upon Congress to rethink the bankruptcy process completely.[81] Although the Brookings Institution study was primarily focused on consumer (individual) bankruptcies following the explosion of consumer credit during the 1960s, the National Bankruptcy Review Commission, appointed in 1970, included many of the Brookings Institution's recommendations to overhaul the business reorganization process under the Bankruptcy Act of 1898 (as amended by the Chandler Act) in its report.[82]

The 1978 Act codified a new Chapter 11 of a new title 11 of the U.S. Code, which remains the general template for corporate reorganizations and represents the combination of certain aspects of chapters X, XI, and XII of the Chandler Act. Congress intended Chapter 11 to eliminate the controversy that often surrounded a debtor's choice of a particular chapter: "[a] single chapter for all business reorganizations will simplify the law by eliminating unnecessary differences in detail that are inevitable under separately administered statutes. . . ." and "will eliminate unprofitable litigation over the preliminary issue as to which of [chapters X or XI] apply."[83] It was also designed to respond to the widely held grievance that "existing law did not have adequate mechanisms to facilitate corporate rehabilitation in a straightforward, predictable way."[84] The new Chapter 11 combined the flexibility and debtor control that characterized Chapter XI with many of the public protection features central to Chapter X.[85]

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[80] Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 32 (1995).

[81] SKEEL, *supra* note 18, at 142.

[82] *See id.* at 143.

[83] S. REP. No. 95-989, at 9 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5795.

[84] Bruce G. Carruthers & Terence C. Halliday, *Professionals in Systemic Reform of Bankruptcy Law: The 1978 U.S. Bankruptcy Code and the English Insolvency Act 1986*, 74 AM. BANKR. L.J. 35, 44 (2000).

[85] 1 WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE 2D § 3:13 (perm. ed., rev. vol. 2005).

A. *Encouraging Rehabilitation Through Debtor Protections*

Among the principal objectives of the 1978 Act were to make bankruptcy a more appealing option than it had been in the past and address the "great stresses . . . in the bankruptcy system"[86] that had arisen as both the number of bankruptcy filings, as well as their complexity, increased. Offering court-supervised reorganization procedures, the 1978 Act was designed to provide "bankrupt businesses another opportunity to succeed."[87] Two issues predominated the adoption of the more flexible, streamlined, and rehabilitation-friendly Chapter 11: (1) whether to mandate trustees for large debtors and (2) the appropriate role of the SEC.[88] The resolution of both issues reflected Chapter 11's strong presumption in favor of the debtor-in-possession concept. Under the 1978 Act, trustees may be appointed only for cause, reflecting Congress' view that, absent fraud or incompetence, reorganization would be best effectuated by allowing the debtor to continue to operate its business as debtor-in-possession.[89] Even if a trustee is appointed, the court may, at any point before confirmation, terminate the trustee's appointment and restore the debtor-in-possession to management and operation of the business.[90] As for the SEC, Chapter 11 provided no specific statutory role other than the ability to participate as a party-in-interest.[91] Chapter 11 thus eliminated SEC oversight of the reorganization process.[92]

Other provisions further enhanced the "comfort zone" that Chapter 11 provided to debtors and management and encouraged filing before a debtor's financial position deteriorated beyond the point that rehabilitation would no longer be feasible.[93] Such enhancements included: (a) the automatic stay of action against the debtor, its properties, and properties in the possession of the debtor upon commence-

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[86] S. Rep. No. 95-989, at 3, *reprinted in* 1978 U.S.C.C.A.N. at 5789.

[87] Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775, 787 (1987).

[88] *See* Skeel, *supra* note 18, at 177.

[89] H.R. Rep. No. 95-595, at 233 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6192 ("[V]ery often the creditors will be benefited by continuation of the debtor in possession, both because the expense of a trustee will not be required, and the debtor, who is familiar with his business, will be better able to operate it during the reorganization case.").

[90] *See* 11 U.S.C. § 1105 (2000).

[91] Ali M. M. Mojdehi, *Appraising Postconfirmation Leaders: The Underutilized Confirmation Requirement*, 77 Am. Bankr. L.J. 199, 207–08 (2003).

[92] *Id.* at 206–07.

[93] Note, *The Manville Bankruptcy: Treating Mass Tort Claims in Chapter 11 Proceedings*, 98 Harv. L. Rev. 1121, 1126 & n.30 (1983) (citing 123 Cong. Rec. 35, 446, (1977) (statement of Rep. Edwards) and noting that both chapters X and XI required the debtor to be insolvent).

ment of a Chapter 11 case;[94] (b) the broad financing power available to debtors;[95] (c) the debtor's expanded authorization to reject executory contracts;[96] (d) a more comprehensive definition of property of the estate; [97] (e) the recovery and return of property of the estate transferred or removed from the debtor's possession prior to the commencement of a Chapter 11 case;[98] (f) the expansion of the debtor's administrative powers;[99] and (g) the debtor's retention of the exclusive right to file a proposed plan of reorganization and to solicit acceptances of such a plan within 180 days, subject to termination, contraction, or extension for cause.[100]

B. *Protection of Non-Debtor Interests*

Congress was mindful of the interest of other parties affected by business failures. The legislative history of the 1978 Act demonstrates that Congress believed that "[t]he purpose of a business reorganization case [under Chapter 11] . . . is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders."[101] With the understanding that "[r]eorganization, in its fundamental aspects, involves the thankless task of determining who should share the losses incurred by an unsuccessful business and how the values of the estate should be apportioned among creditors and stockholders. . . .,"[102] the 1978 Act also provided safeguards to protect the interests of creditors and public investors. Such provisions reflected Congress' intent to balance the interests of all parties involved in the Chapter 11 reorganization process.

Non-debtor protections included in the 1978 Act provide that: (a) the commencement of a Chapter 11 case may be voluntary or involuntary;[103] (b) secured creditors are entitled, if requested, to adequate protection of their interests in property of the estate;[104] (c) the goal of a Chapter 11 restructuring is to achieve a consensual plan of

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[94] 11 U.S.C. § 362.
[95] *See id.* § 364.
[96] *See* 11 U.S.C. § 365 (2000).
[97] *See id.* § 541.
[98] *Id.* §§ 542–43.
[99] *See id.* §§ 361–366.
[100] *Id.* § 1121.
[101] H.R. Rep. No. 95-595, at 220 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179.
[102] S. Rep. No. 95-989, at 10 (1978), *reprinted in* U.S.C.C.A.N. 5787, 5796.
[103] 11 U.S.C. §§ 301, 303 (2000).
[104] *Id.* §§ 361, 363.

reorganization accepted by certain requisite majorities of various classes of voting-impaired creditors and equity holders;[105] (d) solicitation of acceptances or rejections of a proposed plan may not occur until a disclosure statement has been approved by the bankruptcy court, after notice and a hearing, and upon a finding that the statement contains "adequate information" to enable creditors and equity holders the opportunity to cast an informed vote;[106] (e) the office of the U.S. trustee (initially as an experimental program and now as a permanent program) will oversee the administration of Chapter 11 cases;[107] (f) the debtor must provide due process protections, such as notice and a hearing, to creditors prior to obtaining the entry of orders and judgments;[108] and (g) the plan must fully comply with confirmation requirements, including an expanded feasibility standard and a best-interests-of-creditors test.[109]

Congress also appreciated that the revival of an otherwise failing business served interests of non-creditors, including older employees, customers, suppliers, and property owners.[110] As Harvard Law School Professor Elizabeth Warren has observed, "[c]ongressional comments on the Bankruptcy Code are liberally sprinkled with discussions of policies to 'protect the investing public, protect jobs, and help save troubled businesses,' of concern about the community impact of bankruptcy, and of 'the public interest' beyond the interests of the disputing parties."[111]

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[105] *See id.* § 1126.

[106] *Id.* § 1125.

[107] *Id.* § 307.

[108] FED. R. BANKR. P. 2002. For a definition of "notice and a hearing," see 11 U.S.C. § 102.

[109] *See* 11 U.S.C. §§ 1123, 1129 (2000); *In re* Gen. Teamsters, Warehousemen & Helpers Union, Local 890, 265 F.3d 869, 877 (9th Cir. 2001); *see also* Kane v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 843 F.2d 636, 649 (2d Cir. 1988) (stating that the best interests test requires "a finding that each holder of a claim or interest either has accepted the plan or has received no less under the plan than what he would have received in a Chapter 7 liquidation").

[110] Warren, *supra* note 87, at 787–87.

[111] *Id.* at 788 & n.24 (quoting 124 CONG. REC. 32392 (1978) (statement of Rep. Edwards)); *see* H.R. REP. No. 95-595, at 53–62 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6014–23 (letter from Judge Conrad Cyr responding to congressional request for information about cases with special community impact); H.R. DOC. No. 93-137, at 72 (1973); 124 CONG. REC. 33990 (1978) (statement of Sen. DeConcini).

C. *Judicial Interpretation of the Bankruptcy Code*

From the outset, the Bankruptcy Code[112] was understood to be a flexible document, with its provisions to be shaped and interpreted to meet the needs of the Congressional policy of furthering rehabilitation. Early caselaw illustrates the manner in which policy considerations behind the 1978 Act encouraged a pragmatic view and application of the Bankruptcy Code.

In *United States v. Whiting Pools, Inc.*,[113] the Court of Appeals for the Second Circuit, relying upon the policy considerations of the 1978 Act as well as on sections 541 and 542 of the Bankruptcy Code as statutory predicates, expanded the power of the debtor to obtain a turnover order under section 542(a) of the Bankruptcy Code.[114] The debtor in *Whiting Pools*, pursuant to section 542 of the Bankruptcy Code, sought to require the Internal Revenue Service ("IRS") to turn over property that it had levied shortly before Whiting filed for bankruptcy.[115] Whiting was in the business of selling, installing, and servicing swimming pool equipment, and the IRS, acting pursuant to Internal Revenue Code § 6331, seized and took control of all of Whiting's tangible property, including equipment, vehicles, inventory, office equipment, and supplies, all of which were "absolutely necessary to an effective reorganization of the debtor."[116] The estimated worth of the seized property in the control of Whiting as a going concern was $162,876, the IRS lien was for approximately $92,000 plus interest, and the estimated liquidation value for the property was, at most, $35,000, with a high likelihood that sale proceeds would be in the $20,000 range.[117]

The IRS argued that the plain meaning of section 542 did not mandate turnover in this case because, at the commencement of the case, the debtor's interests in the property were only those set out in the IRS levy statute, namely a right to notice of the seizure/sale, redemption prior to sale, and a right to surplus proceeds.[118] The Second Circuit disregarded the IRS's "mechanical interpretation," determining that "the Government's reading of the Bankruptcy Code would seriously affect the chances of success in many reorganizations. . . . In

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[112] *See* 11 U.S.C. §§ 101 *et seq.* (2000).

[113] 674 F.2d 144 (2d Cir. 1982), *aff'd*, 462 U.S. 198 (1983).

[114] *See generally id.*

[115] *Id.* at 145–46.

[116] *Id.* (quoting United States v. Whiting Pools, Inc. (*In re* Whiting Pools, Inc.), 10 B.R. 755, 757 (Bankr. W.D.N.Y. 1981)).

[117] *Id.*

[118] *Id.* at 149–50.

light of legislative history indicating that reorganizations were to be encouraged under the new Code, we doubt that Congress intended such a result."[119] The court instead found that a narrow definition of property of the estate would have a "far-reaching effect on reorganizations by denying to debtors or trustees in reorganization not only the power to obtain the turnover of property of the debtor levied upon by the IRS, but also that repossessed prior to bankruptcy by secured creditors or held by pledgees after a default."[120]

The Supreme Court affirmed the Second Circuit's holding, thereby upholding the debtor's right to regain possession and use of property necessary to its ongoing business and generally prioritizing the ability of a debtor to restructure successfully over the ability of the federal government to collect taxes.[121] The Court echoed the Second Circuit's concern for a flexible approach to interpreting the Bankruptcy Code in order to facilitate reorganization: "By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners."[122] The Court also emphasized the breadth of the definition of "property of the estate" in the context of the legislative history of the 1978 Act, stating that "[b]oth the congressional goal of encouraging reorganizations and Congress' choice of methods to protect secured creditors suggest that Congress intended a broad range of property to be included in the estate."[123]

In *NLRB v. Bildisco & Bildisco*, the Supreme Court again emphasized the policy goals of the Bankruptcy Code: "[t]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of eco-

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[119] *Id.* at 150, 152 & n.13 (citing 123 CONG. REC. H. 11,697 (daily ed. Oct. 27, 1977)).

[120] *Whiting Pools, Inc.*, 674 F.2d at 150.

[121] *See* United States v. Whiting Pools, Inc., 462 U.S. 198, 211–12 (1983).

[122] *Id.* at 203 (citing H.R. REP. No. 95-595, at 220 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179).

[123] *Id.* at 203–04. Interestingly, the Supreme Court also interpreted the IRS levy statute to narrow the IRS's interest in the property to that of a right to legal custody and nothing more, rejecting the IRS's contention that the debtor's interests in the property were only, for instance, a right to notice of the seizure/sale or a right to surplus proceeds. *See id.* at 210–11 ("In fact, the tax sale provision itself refers to the debtor as the owner of the property after the seizure but prior to the sale. Until such a sale takes place, the property remains the debtor's and thus is subject to the turnover requirement of § 542(a).") (citation omitted). It is possible that the Supreme Court was attempting to narrow the Second Circuit's reliance on a broad definition of "property of the estate" by instead narrowly interpreting the IRS's rights to the debtor's property under the IRS levy statute to fall outside of a less broad definition. Nevertheless, this is unlikely given the Supreme Court's lengthy discussion of the Bankruptcy Code's policy objectives. *See id.* at 204.

nomic resources."[124] In a controversial holding, the Court rejected the argument that collective bargaining agreements are not executory contracts and, therefore, are beyond the scope of the rejection powers of section 365 of the Bankruptcy Code.[125] The Supreme Court declined to require a debtor to demonstrate that a reorganization would otherwise fail in order to reject a collective bargaining agreement,[126] a formulation adopted by the Second Circuit in *Brotherhood of Railway v. REA Express, Inc.*[127] The Supreme Court held that, although rejection of collective bargaining agreements should be governed by a stricter standard than the business judgment standard applied to other executory contracts because of the special nature of a collective-bargaining contract and the "law of the shop" it creates, the *REA Express* standard was too stringent and therefore "fundamentally at odds with the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code."[128] The Court thus held that a debtor could rescind a labor contract immediately upon the commencement of a Chapter 11 case.[129] Unfortunately, the public debate sparked by the *Bildisco* decision triggered an immediate congressional response. Congress promptly passed an amendment to the Bankruptcy Code setting forth specific procedures and substantive requirements for the rejection of collective bargaining agreements.[130] Section 1113, the amendatory provision of the Bankruptcy Code that nullified the *Bildisco* holding, provides for an expedited form of collective bargaining, the failure of which is the only avenue for a debtor to reject the labor contract.[131]

Another case illustrating the doctrine of flexibility is *In re Ionosphere Clubs, Inc.*,[132] which is often credited as the seminal case regarding critical-vendor payments and, accordingly, is frequently cited in support of critical-vendor motions.[133] The issue before the court was

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[124] 465 U.S. 513, 528 (1984) (citing H.R. REP. No. 95-595, at 200 (1977)).

[125] *Id.* at 521–23.

[126] *See id.* at 525–27.

[127] Bhd. of Ry., Airline & S.S. Clerks v. REA Exp., Inc., 523 F.2d 164, 167–69 (2d Cir. 1975).

[128] *Bildisco & Bildisco*, 465 U.S. at 525.

[129] *See id.*

[130] *See* 11 U.S.C. § 1113 (2000).

[131] *In re* Century Brass Prods., Inc., 795 F.2d 265, 272 (2d Cir. 1986); *see* 11 U.S.C. § 1113.

[132] 98 B.R. 174 (Bankr. S.D.N.Y. 1989).

[133] A critical-vendor motion seeks authorization to pay claims of "critical vendors," as identified by the debtor and approved by the court. Critical vendors are those who "supply services or material essential to the conduct of the [debtor's] business," such that their continued participation in the debtor's business is necessary for the debtor's ability to

whether the debtor, Eastern Airlines, was required to pay the prepetition wage, salary, and medical benefit claims of all employees, rather than only the claims of active, non-striking employees the debtor considered to be critical for continued operations.[134] According to the International Association of Machinists, the prepetition wage and salary claims of both active and striking employees were priority claims under section 507(a)(3) of the Bankruptcy Code and thus should be treated in the same fashion.[135]

The court, however, held that "[a] rigid application of the priorities of § 507 would be inconsistent with the fundamental purpose of reorganization"[136] and the "paramount policy and goal of Chapter 11, to which all other bankruptcy policies are subordinated . . ., [which] is the rehabilitation of the debtor."[137] In denying relief for non-critical employees and allowing the debtor to make payments solely to active, non-striking employees, the court relied on the equitable power provided by section 105 of the Bankruptcy Code, as well as on section 363(b), which empowers a bankruptcy court to authorize a debtor to expend funds outside the ordinary course of business.[138] According to the court, its use of section 105 in this context went to the very purpose of the Bankruptcy Act's grant of equitable powers to the bankruptcy court, which was "to create a flexible mechanism that will permit the greatest likelihood of survival of the debtor and payment of creditors in full or at least proportionately."[139]

As these cases make clear, rehabilitation and reorganization were the policy goals underlying the enactment of the Bankruptcy Code. In the early years following the 1978 Act, judges did not hesitate to interpret the Bankruptcy Code and exercise their perceived equity powers to achieve and implement that policy.

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reorganize successfully. *In re* Ionosphere Clubs, Inc., 98 B.R. 174, 176 (Bankr. S.D.N.Y. 1989) (quoting *In re* Lehigh & New Eng. Ry. Co., 657 F.2d 570, 581 (3d Cir. 1981) (quoting *In re* Penn Cent. Transp. Co., 467 F.2d 100, 102 n.1 (3d Cir. 1972))). According to the court in *In re Ionosphere Clubs, Inc.*, the debtor must "articulate sound business reasons" that make it "critical for [the debtor] to pay such pre-petition claims in order to preserve and protect its business and ultimately reorganize." *Id.* at 175. The propriety of such payments and the legal reasoning supporting such payments recently has been criticized. *See, e.g.*, *In re* Kmart Corp., 359 F.3d 866, 871–74 (7th Cir. 2004); *In re* Coserv, L.L.C., 273 B.R. 487, 493–95 (Bankr. N.D. Tex. 2002).

[134] *In re Ionosphere Clubs, Inc.*, 98 B.R. at 174–75.

[135] *Id.* at 175.

[136] *Id.* at 178 (quoting *In re* Chateaugay, 80 B.R. 279, 287 (Bankr. S.D.N.Y. 1987)).

[137] *Id.* at 176.

[138] *Id.* at 178.

[139] *Id.* (quoting *In re Chateaugay*, 80 B.R. at 287).

III. The Declining Emphasis on Rehabilitation

A. *The "Clawback" by Creditors and Parties in Interest*

The passage of the 1978 Act ushered in a new era of special-interest legislation designed to meet the needs of a variety of parties. Congress responded to pressures from various special interests by passing specific provisions to protect a particular special-interest group. Thus began the contraction of debtor protections to achieve the congressional policy of rehabilitation and reorganization. Ultimately, the enactment of such special-interest provisions motivated other groups to obtain statutory amendments to protect their interests and the "clawback" protections and powers extended to the debtors.

Purportedly to maintain affordable access for airlines to lease and finance acquisitions of aircraft, section 1110 of the Bankruptcy Code provides aircraft manufacturers, lessors, and financiers with additional protections.[140] Section 1110 is a provision paralleled to section 1168, which originated in section 77(j) of the 1978 Act, and was passed in response to the Supreme Court's ruling in *Continental Illinois National Bank v. Chicago, Rock Island & Pacific Railway*,[141] that a creditor's right to foreclose on a particular railroad asset could be enjoined to preserve going-concern value.[142] Section 1110 of the Bankruptcy Code provides an exception to the automatic stay provision of section 362, allowing financiers to bypass the stay to receive current payments or recover the financed aircraft-related equipment.[143] Supposedly, two negative consequences would arise if the section 1110 exception did not exist: (1) airlines would face prohibitive increases in the cost of aircraft leases—driven by lessors' and financiers' need to account for such risk—and (2) airlines would be unable to acquire new aircraft readily to service additional markets, compete with other airlines, or upgrade aging equipment.[144] It has been argued that, as a result of the section 1110 protections and despite the chronic financial problems plaguing the airline sector, a competitive market for aircraft-related financing developed that benefited the airline industry and the public. The empirical evidence to support this argument, however, is inconclusive.

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[140] 11 U.S.C. § 1110 (2000).

[141] 294 U.S. 648 (1935).

[142] 11 U.S.C. §§ 1110, 1168.

[143] Kathryn Hoff-Patrinos, *Aviation Finance Revisited: The 1994 Amendments to Section 1110 of the Bankruptcy Code*, 69 Am. Bankr. L.J. 167, 168–69 (1995).

[144] *See* 11 U.S.C. § 1110.

Certain financial institutions receive special protection under the Bankruptcy Code. Safeguards are designed to provide incentives for such institutions to enter into transactions with financially troubled companies, to preserve the liquidity of the nation's financial markets, and to remove the uncertainties of bankruptcy as a limiting factor in the formation and execution of such transactions. For example, the Bankruptcy Code grants financial institutions that conduct derivative transactions the right to set off mutual claims despite the automatic stay and permits them to exercise otherwise unenforceable ipso facto provisions.[145]

Commercial property owners also receive special protections under the Bankruptcy Code.[146] While section 365 of the Bankruptcy Code generally allows a debtor to delay its decision to assume or reject an executory contract until confirmation of its plan of reorganization, section 365(d)(4) limits the time within which a debtor may assume a lease of nonresidential property to sixty days from the date of commencement of the Chapter 11 case, subject to extension for cause.[147] In addition to the sixty-day limitation of section 365(d)(4), shopping center lessors have received further protections pertaining to the assumption of leases within their shopping centers, in the form of adequate assurance of performance provisions.[148] Such protections, codified in section 365(b)(3), are justified by proponents by the interdependencies among tenants of shopping centers and the resulting impact that each tenant has on others.[149]

Equipment lessors are also protected by section 365(d)(10) of the Bankruptcy Code, adopted in 1994, under which a debtor is obligated to make all payments required under a lease of personal property arising sixty days after the commencement of the Chapter 11 case.[150] This provision is designed to protect such a lessor from a debtor who retains the lessor's property and attempts to limit the lessor's administrative expense claim through section 503(b)(1), which

[145] *See, e.g.*, 11 U.S.C. §§ 362(b)(6), 362(b)(7), 555, 556, 559, & 560. These sections of the Code were adopted in 1978, 1978, 1982, 1982, 1984, and 1990, respectively, and subsequently expanded.

[146] *See* 11 U.S.C. § 365 (2000).

[147] *Id.* § 365(d)(4).

[148] *See id.* § 365(b)(3).

[149] *Id.*; John D. Ayer et al., *Bankruptcy Issues for Landlords and Tenants*, AM. BANKR. INST. J., Oct. 2004, at 16, 54–55.

[150] *See* 11 U.S.C. § 365(d)(10).

allows for administrative expenses that are the "actual, necessary costs and expenses of preserving the estate."[151]

B. *The Creditor-in-Possession*

The increasing influence of creditors has fundamentally changed the reorganization process, with wide-ranging and far-reaching effects both prior to and during a company's decision to commence a Chapter 11 case. This Section identifies and analyzes two contributing causes: (1) distressed-debt trading and (2) debtor-in-possession financing.

Distressed-debt trading has grown to proportions never contemplated when the 1978 Act was enacted. It has meaningfully transformed the relationship between debtors and creditors. In the 1970s and 1980s, that relationship was generally symbiotic. Prior to globalization and technological advancements such as the Internet, suppliers, purchasers, and lenders often shared long-standing commercial relationships and, as a result of geographic limitations, were confined to the same areas and local economies. The interdependent nature of fortunes encouraged support when a local enterprise commenced a reorganization case, as it was in the best interests of suppliers and lenders to continue providing materials, products, and support.

The globalization of the economy and the growth of financial markets have fueled distressed-debt trading,[152] a phenomenon that has upset the symbiotic relationship between a debtor and its creditors. Unsophisticated suppliers who are unwilling to navigate the recovery of their claims through the Chapter 11 process now easily liquidate their claims by selling them for cash at a discount to distressed-debt traders.[153] Creditor financial institutions no longer feel con-

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[151] *See id.* § 503(b)(1); Ayer et al., *supra* note 149, at 54.

[152] The onset of large-scale debt trading is generally attributed to the 1991 amendment to Federal Rule of Bankruptcy Procedure 3001(e). Before 1991, claimants had greater access to information that enabled them to make informed decisions on whether they should sell their claims. By contrast, the current version of Bankruptcy Rule 3001(e) no longer requires the disclosure of the "terms of the transfer" and "the consideration therefor," which were viewed as frustrating the goal of providing a liquid market for the sale of claims. Today, Bankruptcy Rule 3001(e) simply requires the transferee to provide evidence of the transfer to the court. Fed. R. Bankr. P. 3001(e); Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 Vand. L. Rev. 1987, 2015–16 (2002).

[153] Even to the extent that trade creditors do not sell their claims and are willing to work patiently with the debtor to ensure its rehabilitation, trade creditors' role in Chapter 11 cases appears to be waning. For example, one would expect Winn-Dixie, a grocery retailer with goods comprising its main cost of doing business, to have a large proportion of trade debt. Instead, the trade debt accounted for only roughly twenty percent of Winn-Dixie's debt at the commencement of its Chapter 11 cases. *See generally In re* Winn-Dixie Stores, Inc., No. 05–

strained by relationships with management and may choose not to carry large defaulted loans, which must be marked to market with attendant financial statement charges to the lender. Accordingly, financial institutions often seek liquidity and lower risk, and thus sell the debt notwithstanding any prior relationship with a particular debtor.

Distressed-debt traders have different motivations from commercial creditors providing goods and services or lenders. They buy claims of all types at substantial discounts. Rather than nurture long-term relationships, distressed-debt traders purchase debt claims to reap material profits and, in certain situations, to obtain control of the debtor and dominate the administration of the reorganization case through membership on the creditors' committee. In either case, the perspective of the distressed-debt trader is that time is of critical importance in order to maximize the return on investment. The sooner a trader or a group of traders can force a debtor to emerge from Chapter 11, the sooner the traders' claims can be monetized—regardless of any other factor, including whether or not the debtor had been fully rehabilitated when it was pressured to exit the Chapter 11 reorganization process. This paradigm may be a material contributing factor to the recidivism rate and Chapter 11 debtors' eventual return to the bankruptcy court.

Distressed-debt traders, primarily hedge funds, constitute a sophisticated set of players in the Chapter 11 arena who continue to grow increasingly familiar with Chapter 11 and who are unwilling to sacrifice recovery for the sake of the debtor's rehabilitation. Distressed-debt traders' entry into the reorganization process has transformed Chapter 11 reorganizations from primarily rehabilitation to the fulfillment of laissez-faire capitalism focused on the realization of substantial profit-taking.

In tandem with the growing dominance of the distressed-debt traders/hedge funds, lenders, including hedge funds who increasingly have supplanted banks and other financial institutions, have also grown increasingly sophisticated in gaining influence and control over a debtor through debtor-in-possession financing ("DIP financing"). DIP financing agreements generally take the form of a revolving credit facility, with amounts borrowed due on a regular and relatively short-term basis.[154]

11063 (RDD) (Bankr. S.D.N.Y. Feb. 21, 2005) (first-day affidavit of Bennett L. Nussbaum reporting total liabilities of $1.9 billion, but accounts payable of only $410 million as of January 12, 2005, approximately five weeks before the Chapter 11 filing).

[154] *See generally id.*

They typically include regular reporting requirements to allow the lenders to evaluate the debtor's performance frequently and to determine whether the loan should be rolled over.[155] Because debtors that file for Chapter 11 protection increasingly have balance sheets that are encumbered by large amounts of secured debt—meaning they have a real need to turn to DIP financing,[156] negotiations over DIP loan agreements have become more and more one-sided, with lenders' leverage substantially enhanced by pre-Chapter 11 liens and security interests. Such leverage has enabled DIP lenders to impose increasingly severe covenants and conditions on the debtor and its activities to the point that control of the Chapter 11 case has been taken away from the bankruptcy court.[157]

For example, a DIP lender may insist that the debtor hire a chief restructuring officer ("CRO").[158] CROs are typically vested with executive decision-making power and direct access to the debtor's board, but they can talk to the lenders without reporting back to the board. Many DIP loan provisions can constrain management flexibility and pressure the debtor into selling its assets. A DIP lender may insist upon, for example, highly restrictive cash flow covenants in the loan agreement.[159] Other examples include drop-dead dates, events of default, negative covenants, and consent requirements that may go so far as to prohibit the filing of a Chapter 11 plan without the prior written consent of the lenders.[160]

The Chapter 11 process is increasingly dominated by the "creditor-in-possession," which may explain recidivism rates that have been calculated to be as high as 42% in some districts.[161] Despite the feasi-

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155 *See generally id.*

156 *See* David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 925 (2003).

157 *See* Harvey R. Miller et al., Debtor Dispossessed: The Rise of the "Creditor-In-Possession" and Chapter 11 Asset Sales—Does Chapter 11 Have a Future for Debtors? 13–16 (Mar. 20, 2004) (unpublished manuscript, on file with the authors).

158 *Id.* at 13.

159 For example, the management of United Airlines was compelled to terminate much of its workforce and renegotiate its collective bargaining agreement in order to comply with the cash flow requirements of the company's DIP agreement. *Id.* at 13–14.

160 *See* Marcia L. Goldstein et al., *Current Issues in Debtor in Possession Financing, in* DEALING WITH SECURED CLAIMS & STRUCTURED FINANCIAL PRODUCTS IN BANKRUPTCY CASES 2003, at 147, 154 (2003). Have we returned to the practices characterized as "evils" in the 1930s SEC study of the protective committees and equity receiverships? *See generally* U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL, AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES [PART I] (1937).

161 Harvey R. Miller & Shai Y. Waisman, *The Creditor in Possession*, BANKR. STRATEGIST, Nov. 2003, at 1, 2, 6, 7.

bility requirement of section 1129(a)(11) of the Bankruptcy Code, the bankruptcy judge is dependent upon the parties to present the necessary facts, upon which the judge will either confirm or deny a plan. Courts do not have the means to assess independently a plan's feasibility when presented and supported by the debtors and the creditors. To a large degree, the bankruptcy judge is a captive of the parties, even when a group of creditors exerts a disproportionate influence on the process.

Management is often unable to counterbalance the influence of creditors in Chapter 11. At the outset, management, fearing a loss of control in the current environment, is often reluctant to commence a Chapter 11 case, often waiting only until the last moment to use Chapter 11, which could be after the debtor has a realistic chance of being rehabilitated. Conversely, once a Chapter 11 case has commenced, management often has every incentive to cooperate with lenders. Perhaps senior management is simply reading the proverbial "writing on the wall." At the outset of many cases, it is often obvious that creditors will eventually own the reorganized debtor. Managements desiring a future role with the reorganized debtor will, therefore, have an incentive to appease their future owners.[162] Other times, lenders are able to change the debtor's management team to their advantage. An empirical study found that, during times of financial distress, there is a 52% likelihood of senior management turnover in any year in which the debtor declares bankruptcy or engages in an out-of-court restructuring.[163] The same study found that lenders were responsible one out of every five times such management changes occurred.[164]

Accordingly, creditors (increasingly in the form of distressed-debt traders), consistent with the adage that time is money and facing little resistance, often pressure a debtor to emerge quickly from Chapter 11 and push the debtor to formulate and present hastily a plan of reorganization. All too often this occurs before the remedial work has been done, so the reorganized debtor fails once again. The result is

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[162] *See* Miller et al., *supra* note 157, at 17.

[163] *See* Stuart C. Gilson & Michael R. Vetsuypens, *Creditor Control in Financially Distressed Firms: Empirical Evidence*, 72 WASH. U. L.Q. 1005, 1011 (1994) (citing Stuart C. Gilson, *Management Turnover and Financial Distress*, 25 J. FIN. ECON. 241 (1989)).

[164] *Id.*; *see* Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 737 (1993) (finding that creditors participated in eighteen of forty CEO firings in large publicly traded firms that filed for Chapter 11).

Chapter 22, sometimes Chapter 33, to use proverbial characterizations.[165]

C. *The Increasing Prevalence of Section 363(b) Sales*

The prevalence of asset sales under section 363(b) of the Bankruptcy Code[166] in the context of Chapter 11 is attributable to many factors besides increasingly powerful creditors. Robust capital markets facilitate the pooling of massive amounts of capital by groups of investors, typically in the form of alternative investment vehicles such as private equity and leveraged buyout funds, hedge funds, and vulture funds, in order to purchase or control companies of sizes previously not thought possible (for example, RJR Nabisco, Kmart, Toys "R" Us, Sungard). Additionally, with the ability of such funds to cooperate, few companies are outside the realm of acquisition possibility based on size. Assets are increasingly fungible, implying that the number of potential buyers of assets of any Chapter 11 debtor is growing. The Bankruptcy Code itself creates incentives to engage in asset sales; because section 363 offers the ability to convey assets "free and clear," a debtor sometimes may file for Chapter 11 to implement a sale of all or substantially all of its assets under section 363(b) without any intention to attempt a rehabilitation of the business.[167] This unique ability to cleanse the assets of a distressed company attracts potential purchasers because it potentially removes the uncertainty of successor liability, fraudulent transfer claims, and lien issues that often accompanies asset purchases. Chapter 11 thus facilitates the creation of a market for the sale.

Notwithstanding the foregoing factors, the creditor-in-possession phenomenon has certainly contributed to the increasing prevalence of bankruptcy sales. Creditors often prefer Chapter 11 as a mecha-

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165 *See generally In re* US Airways Group, No. 02–83984 (SSM) (Bankr. E.D. Va. 2002); *In re* Trans World Airlines, Inc., No. 01–00056 (PJW) (Bankr. D. Del. 2001); *In re* US Airways Group, No. 02–83984 (SSM) (Bankr. E.D. Va. 1997); *In re* Jamesway Corp., No. 95–44821 (REG) (Bankr. S.D.N.Y. 1995); *In re* Jamesway Corp., No. 93–43697 (JLG) (Bankr. S.D.N.Y. 1993); *In re* Trans World Airlines, Inc., No. 92–00115 (HSB) (Bankr. D. Del. 1992).

166 *See generally In re* AT&T Latin Am. Corp., No. 03–13538 (RAM) (Bankr. S.D. Fl. 2003); *In re* Top-Flite, Inc., No. 03–12003 (MFW) (Bankr. D. Del. 2003); *In re* Velocita Corp., No. 02–35895 (DHS) (Bankr. D.N.J. 2002); *In re* Budget Group, No. 02–12152 (MFW) (Bankr. D. Del. 2002); *In re* Loews Cineplex Entm't Corp., No. 01–40346 (ALG) (Bankr. S.D.N.Y. 2001); *In re* Bethlehem Steel Corp., No. 01–15288 (BRL) (Bankr. S.D.N.Y. 2001); *In re* Polaroid Corp., No. 01–10864 (JPW) (Bankr. D. Del. 2001); *In re* ANC Rental Corp., No. 01–11200 (MFW) (Bankr. D. Del. 2001); *In re* Trans World Airlines, Inc., No. 01–00056 (PJW) (Bankr. D. Del. 2001).

167 Baird & Rasmussen, *supra* note 9, at 751–52 (citing the bankruptcies of Trans World Airlines and Enron).

nism to facilitate asset sales rather than as a tool for reorganization, given that immediate sales produce a greater certainty of return. Distressed-debt traders, for example, often consider an extended Chapter 11 process to be undesirable, given that their primary concern is achieving a quick return on their investments. DIP lenders, which are often senior secured creditors, also may favor asset sales in Chapter 11, given that they face limited upside potential but significant downside risk from an extended Chapter 11 case.

D. *The Political Environment*

Since the mid-1990s, there has been a judicial trend toward strictly construing and emphasizing the plain meaning of the language of the Bankruptcy Code in its application, as opposed to what is pejoratively described as legislating from the bench.[168] This trend emphasizes predictability, rights, and legislative fiat. Creative applications of the principles and policies of the Bankruptcy Code to further a debtor's rehabilitation, its proponents argue, cannot be extended by a bankruptcy court in the absence of express statutory provisions empowering the court to provide such relief. This trend stands in stark contrast to the flexibility and practicality of the bankruptcy courts that initially interpreted and applied the Bankruptcy Code. The result has been judicial decisions that ignore the predominant rehabilitation policy objective that underlies the 1978 Act. This conservative but currently popular view of the judicial function may hamper the ability of a debtor to reorganize effectively and also ignores the fact that a reorganization case is a socioeconomic legal process that requires flexibility and creativity to achieve the legislative objectives.

Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)[169] is a prime example of the unfortunate consequences of the strict constructionists. In that case, the Court of Appeals for the Ninth Circuit held that the proper interpretation of section 365(c)(1) of the Bankruptcy Code is the plain meaning of its language, which establishes a so-called hypothetical test to govern the assumption of executory contracts.[170] The decision prevents a debtor, as a debtor-in-possession, from assuming a non-assignable executory contract, even

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[168] *See, e.g.*, Scott F. Norberg, *Classification of Claims Under Chapter 11 of the Bankruptcy Code: The Fallacy of Interest Based Classification*, 69 AM. BANKR. L.J. 119, 126 n.27 (1995); *Foreword* to *Bankruptcy Developments Journal*, 10 BANKR. DEV. J. vii, vii–ix (1994).

[169] 165 F.3d 747 (9th Cir. 1999).

[170] *See id.* at 749–50.

when the debtor has no intention of assigning the contract.[171] The decision blithely ignores the legal construct that the debtor and the debtor-in-possession constitute the same entity and, therefore, the entity whose performance the counterparty had voluntarily agreed to accept. Rather, the decision enables the counterparty to take advantage of the occurrence of Chapter 11 to repudiate the agreement and obtain a windfall. As a result, the debtor's estate is deprived of the value of the executory contract to the detriment of all of the debtor's creditors other than the counterparty. By focusing on the plain meaning of the Bankruptcy Code[172] instead of the underlying policy of rehabilitation, this decision seriously impairs the ability of Chapter 11 debtors to reorganize by depriving them of the economic benefit of assuming executory contracts with favorable terms if such contracts are not hypothetically assignable.[173]

Similarly, in *United Phosphorus, Ltd. v. Fox (In re Fox)*,[174] the Bankruptcy Appellate Panel of the Court of Appeals for the Tenth Circuit held that creditors may not bring derivative suits on behalf of the bankruptcy estate.[175] In so holding, the panel focused on the literal language of section 548 of the Bankruptcy Code, which authorizes the *trustee* to avoid transfers.[176] In choosing not to follow the Third Circuit's decision in another case, *Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*,[177] the *Fox* panel discounted what it at least acknowledged as better policy: "*Cybergenics* discusses many reasons why it would be good policy for parties other than the trustee to bring derivative complaints, and it is hard to disagree with the reasons set forth by the majority."[178] The court continued, though, to decline the invitation to be guided by such policy considerations:

> We, however, believe this reasoning is best considered by Congress, and it is not up to us to create a remedy for creditors it has not granted to them, especially when that right is

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[171] *See id.* at 750.

[172] *See* 11 U.S.C. § 365(c) (2000) ("The trustee may not assume *or* assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties . . . .") (emphasis added).

[173] *Perlman*, 165 F.3d at 753.

[174] 305 B.R. 912 (B.A.P. 10th Cir. 2004).

[175] *Id.* at 916.

[176] *See id.* at 914–15.

[177] 330 F.3d 548, 580 (3d. Cir. 2003).

[178] *Fox*, 305 B.R. at 916.

given exclusively to the trustee. Here, the statute is absolute and allows us no discretion to vary from what it says.[179]

Instead, the B.A.P. adhered to the plain meaning rule and the Supreme Court's admonition in *Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A.*,[180] that a plain and unambiguous statute should not be embellished.[181]

In *In re Armstrong World Industries, Inc.*, the court laid out perhaps one of the strongest-worded rebukes of judicial flexibility.[182] After extensive negotiations, the debtor filed its fourth plan of reorganization.[183] At issue and a key part of this plan was the consent by the asbestos personal injury claimants to share a portion of their proposed distribution with equity holders.[184] The bankruptcy court issued proposed findings of fact and conclusions of law along with a proposed confirmation order, and certain unsecured creditors who had previously indicated support of the debtor's plan filed objections with the district court.[185] The district court denied confirmation of the plan, holding that it violated the fair and equitable (absolute priority) rule, by allowing equity holders to receive the debtor's property on account of their ownership interest before unsecured creditors had been paid in full.[186] The court warned: "Bluntly put, no amount of legal creativity or counsel's incantation to general notions of equity or to any supposed policy favoring reorganizations over liquidation supports judicial rewriting of the Bankruptcy Code."[187]

The growing influence of creditors, particularly secured creditors, and the increasing emphasis both on enforcing parties' contractual and statutory rights and on strictly interpreting the plain language of the Bankruptcy Code, has found unity and intellectual justification in aca-

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[179] *Id.* (citation omitted).

[180] 530 U.S. 1 (2000).

[181] *Fox*, 305 B.R. at 916.

[182] *See* 320 B.R. 523, 540 (D. Del. 2005).

[183] *Id.* at 525.

[184] *Id.* at 526.

[185] *See id.* at 531.

[186] *Id.* at 536.

[187] *In re Armstrong World Indus., Inc.*, 320 B.R. at 540; *see* United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986) ("While the bankruptcy courts have fashioned relief under Section 105(a) in a variety of situations, the powers granted by that statute may be exercised only in a manner consistent with the provisions of the Bankruptcy Code. That statute does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity.").

demic circles under the name of "contractualism."[188] Under a contractual model, there is no need for a court-supervised insolvency process because the most suitable private party, through contract, is allocated decision-making responsibility.[189] Upon default by the borrower (or even before), control shifts to such party per agreement and this party makes business decisions such as when to shutter the business. The contractual model eschews governmental oversight and entrusts private parties with the responsibility of allocating control rights efficiently. From this perspective, the control that secured creditors and DIP lenders procure through restrictive terms and conditions of loan agreements is acceptable, even desirable. Some argue that contractualism is already in place.[190]

IV. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

Representing the most comprehensive set of reforms to the Bankruptcy Code in more than twenty-five years, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[191] (the "Abuse Act") is designed to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensuring fairness to both debtors and creditors.[192] The Abuse Act pertains to both consumer and business bankruptcy and includes provisions intended to reduce systemic risk in the banking system and financial marketplace, as well as a separate chapter addressing transnational insolvencies, both in response to trends in the globalization of business management and operations and in order to provide greater legal certainty for trade and investment.[193]

President Bush signed the Abuse Act into law on April 20, 2005, and most provisions took effect on October 17, 2005.[194] The Abuse

[188] *See, e.g.*, Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 Tex. L. Rev. 795, 827–30 (2004).

[189] *See, e.g.*, Baird & Rasmussen, *supra* note 9, at 781 (citing Webvan as a paradigmatic example). One can analogize to the control obtained by DIP lenders over a debtor through the DIP loan agreement, which, if sufficiently overreaching, allows the DIP lenders the right effectively to run the debtor's operations.

[190] Westbrook, *supra* note 188, at 829.

[191] *See generally* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (to be codified in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., and 28 U.S.C.) [hereinafter "BAPCPA"].

[192] H.R. Rep. No. 109-31(Part 1), at 1–2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89.

[193] *See id.* at 2–4, *reprinted in* 2005 U.S.C.C.A.N. at 89–90.

[194] *See* BAPCPA, Pub. L. No. 109-8, 119 Stat. 23.

Act represents the culmination of nearly eight years of proposed legislation. The House of Representatives has passed bankruptcy reform legislation on eight occasions since the 105th Congress,[195] and the Senate has passed legislation on four occasions and has held numerous hearings on the subject of bankruptcy reform.[196] Notwithstanding President Clinton's veto of such legislation during the 106th Congress, bankruptcy reform legislation survived and now has found enactment with bipartisan, bicameral support, the lobbying for which was largely financed by credit card issuers and banks.[197]

The legislative history of the Abuse Act indicates several motivations for reform: (1) an increase in the number of consumer bankruptcy filings and alleged associated creditor losses, as well as adverse financial consequences for the economy as a whole; (2) the use of loopholes and other abusive practices; and (3) the lack of a clear mandate for debtors to repay their debts to the best of their abilities.[198] However, whether the Abuse Act does in fact respond to such "significant developments"[199] has been questioned. According to the Senate testimony of Professor Warren, "The overarching problem with this bill is that time and the American economy have passed it by. . . . [T]he events of the past eight years have dramatically changed the economic and social environment in which [the bill must be considered]."[200] The legislative history demonstrates that this balance was a matter of discussion; in the context of consumer bankruptcy legisla-

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[195] In the 105th Congress, the House passed H.R. 3150, the "Bankruptcy Reform Act of 1998," and the conference report on that bill. In the 106th Congress, the House passed H.R. 833, the successor to H.R. 3150, and agreed to the conference report. In the 107th Congress, the House passed H.R. 333, the "Bankruptcy Abuse Prevention and Consumer Protection Act," and a modified version of the conference report on H.R. 333. In the 108th Congress, the House passed H.R. 975, the "Bankruptcy Abuse and Consumer Protection Act of 2003" and S. 1920, which consisted of the text of H.R. 975, as passed by the House. H.R. REP. NO. 109-31(Part 1), at 6, *reprinted in* 2005 U.S.C.C.A.N. 88, 92–93.

[196] The Senate passed legislation in each of the 105th, 106th and 107th sessions of Congress, as well as a conference report in the 106th Congress. *Id.* at 6, *reprinted in* 2005 U.S.C.C.A.N. at 93.

[197] *See, e.g.*, Timothy Spence, *Bankruptcy: Senators Pursue Credit-card Reform*, MIAMI HERALD, May 22, 2005, at E4 ("Banks and credit card companies, which lobbied for the law, say it would stop people who live beyond their means and then shirk their debts by declaring bankruptcy.").

[198] *See* H.R. REP. NO. 109-31 (Part 1), at 1–3 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 88–90.

[199] 147 CONG. REC. H517-03, (daily ed. Mar. 1, 2001) (statement of Rep. Sensenbrenner).

[200] *Bankruptcy Reform: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. (2005), http://judiciary.senate.gov/testimony.cfm?id=1381&wit_id=3996 (statement of Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School).

tion, the House Report dated April 8, 2005 states: "these reforms contemplate replacing the current law's presumption in favor of the debtor with a *mandatory* presumption of abuse that would arise under certain conditions."[201]

Initial political commentary on the Abuse Act has focused mainly on its creditor-friendly consumer aspects because the legislation modifies the provisions governing individual bankruptcies more so than business bankruptcies, and these changes are visible to the American public.[202] Not to be lost in the attention given to the consumer provisions, however, is the effect the Abuse Act will likely have on Chapter 11 reorganizations and the delicate balance between the interests of the debtors and creditors.

In some ways, the modifications to the Bankruptcy Code appear to be a continuation of the creditors' clawback of creditor prerogatives and the special-interest legislation that followed the 1978 Act. Creditors, as repeat players in the Chapter 11 game, have a continuing interest in the system. It is the business of banks, credit card issuers, and utilities, for example, to deal with defaulting debtors inside and outside of Chapter 11 on a regular basis and, therefore, these players have a vested interest in the nation's insolvency laws. They are positioned and incentivized to lobby and obtain passage of special-interest legislation. They have been largely successful. In contrast, the interests of debtors are not consistently represented in our pluralist system. Debtors cannot form an effective lobby because of their transient interaction with the insolvency system and their more limited resources and diverse interests. As noted above, the passage of significant bankruptcy legislation to encourage rehabilitation has been sporadic historically. Legislation has been spurred by outcry during the troughs of the economic boom and bust cycle, with the 1978 Act being the notable exception.

An illustrative example is the Abuse Act's modification of section 365(d)(4) of the Bankruptcy Code, the provision that governs a debtor's statutory period to assume or reject an unexpired lease of nonresidential real property.[203] The Abuse Act extends the debtor's time period to assume or reject the lease from sixty to 120 days, but

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[201] H.R. REP. No. 109-31 (Part 1), at 13 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 99 (emphasis added).

[202] *See, e.g.*, Michael Schroeder, *Tough on Debtors, Bankruptcy Bill Advances to Bush*, WALL ST. J., Apr. 15, 2005, at A2 ("[T]he brunt of the overhaul falls on consumers.").

[203] *See* BAPCPA, Pub. L. No. 109-8, § 404, 119 Stat. 23, 104–05 (to be codified at, and amending, 28 U.S.C. § 365).

deprives the court of the ability to grant extensions of the time period for cause shown.[204] Previously, courts had routinely extended the time period, prompting outcries and lobbying from landlords. Now, after one ninety-day extension, any further extension will require the prior written consent of the lessor.[205] If such lease is assumed and eventually rejected, the lessor would be entitled to an administrative expense for money owed under such lease for a period of two years, without regard to actual damages suffered by the lessor.[206]

Similarly, section 366 of the Bankruptcy Code, the provision that governs the treatment of utility companies, protects utility creditors at the expense of the debtor. The Abuse Act extends the time within which a debtor must provide adequate assurance of payment to thirty days, but enhances utility companies' positions by restricting what qualifies as adequate assurance.[207] Adequate assurance must be "satisfactory" to the utility and, while the Abuse Act does not clarify what "satisfactory" means, it specifically excludes administrative expense priority.[208] Additionally, a utility company will now be able to recover or setoff against a prepetition deposit without court approval.[209] Other examples of the creditor clawbacks in the Abuse Act include: (1) the narrowing of the automatic stay with respect to U.S. Tax Court proceedings,[210] setoffs relating to contracts for financial instruments and repurchase agreements,[211] and certain governmental activities such as exclusion from participation in Medicare;[212] (2) extending the time period for creditors to seek reclamation of goods;[213] (3) granting administrative expense status for goods provided twenty days prior to the commencement of a Chapter 11 case;[214] and (4) strengthening

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[204] *See id.*

[205] *Id.*

[206] *See id.*

[207] *See* BAPCPA § 417, 119 Stat. at 100 (to be codified at, and amending, 28 U.S.C. § 366).

[208] *See id.*

[209] *See* BAPCPA § 417, 119 Stat. 23, 100 (to be codified at, and amending, 28 U.S.C. § 366).

[210] *See* BAPCPA § 709, 119 Stat. at 127 (to be codified at, and amending, 28 U.S.C. § 362).

[211] *See* BAPCPA § 907, 119 Stat. at 170–77 (to be codified at, and amending, 28 U.S.C. § 362).

[212] *See* BAPCPA § 1106, 119 Stat. at 192 (to be codified at, and amending, 28 U.S.C. § 362).

[213] *See* BAPCPA § 1227, 119 Stat. at 199–200 (to be codified at, and amending, 28 U.S.C. § 546).

[214] *See* BAPCPA § 1227, 119 Stat. at 200 (to be codified at, and amending, 28 U.S.C. § 503).

the ability of creditors to cause a Chapter 11 case to be converted or dismissed.[215]

These examples of special-interest clawbacks in the Abuse Act, however, do not tell the entire story. In certain ways, the circumstances surrounding the passage of the Abuse Act are reminiscent of the New Deal environment that produced the Chandler Act. Echoing the New Deal mistrust of Wall Street, the recent flurry of high-profile fraud scandals that have caused many small investors to lose significant amounts of money and the length and expense of many Chapter 11 cases have prompted criticism of the Chapter 11 process. The resentment by organized groups of debt traders, landlords, lessors, and others of the purported entrenchment of management and professionals, not unlike the pre-Chandler Act criticism of the professionals' relationship with managers prior to the commencement of receiverships, has been quite vocal. For example, the Abuse Act adds new section 503(c) to the Bankruptcy Code, which places considerable limits on retention bonuses.[216] Under the new section 503(c), retention bonuses can be paid only if: (i) the payment is essential to retaining the person because that person has a "bona fide job offer from another business" with equal or greater compensation and (ii) the services provided by that person are "essential to the survival of the business."[217] Moreover, the new law caps retention bonuses to an amount equal to ten times the amount of similar payments given to non-management employees for any purpose (during the year in which such payment is made) or, if no similar payments were made, no greater than 25% of the amount of any similar payments to such insider for any purpose (during the year in which such payment is made).[218] Certainly responding to the numerous recent fraud cases, the Abuse Act modifies section 1104 of the Bankruptcy Code to require that the U.S. Trustee move for appointment of a Chapter 11 trustee if there are reasonable grounds to suspect current board members, the CEO, or the CFO of fraud, dishonesty, or criminal con-

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[215] *See* BAPCPA, Pub. L. No. 109-8, §§ 102, 316, 442, 119 Stat. 23, 27–35, 92, 115–16 (§§ 102, 316, and 442 to be codified at, and amending, 28 U.S.C. §§ 707, 521, and 1112, respectively).

[216] *See* BAPCPA § 331, 119 Stat. at 102–03 (to be codified at, and amending, 28 U.S.C. § 503).

[217] *See id.*

[218] *See id.*

duct in the management of the debtor or the debtor's public financial reporting.[219]

Perhaps the most significant change to the landscape of Chapter 11 reorganizations is the Abuse Act's effective shortening of the debtor's exclusive periods to file a plan of reorganization and obtain acceptances.[220] Under section 1121 of the Bankruptcy Code as modified by the Abuse Act, extensions of the exclusive periods to file a plan and obtain acceptances are now limited to eighteen and twenty months, respectively, from the commencement of the debtor's Chapter 11 case.[221] Previously, bankruptcy courts granted, for cause and under the appropriate circumstances, several extensions that allowed the debtor to control the bankruptcy process for years.[222]

The wisdom of the change to section 1121 of the Bankruptcy Code is debatable. Although the amendment appears to have been prompted by the length of recent, high-profile Chapter 11 cases such as Owens Corning[223] and Global Crossing,[224] it is unclear that debtors languish under the protection of Chapter 11 because of their lack of diligence in formulating an emergence strategy and filing a plan of reorganization. Many of these cases can be explained by special circumstances. For example, asbestos cases tend to be prolonged because of the unique nature of asbestos claims and the problems associated with estimating thousands of latent claims, devising a plan, and binding the claimants. Similarly, Global Crossing's Chapter 11 case lasted almost two years largely because the debtor's initial plan to sell assets to Hutchison Whampoa and Singapore Telemedia was scrutinized by the Committee on Foreign Investment in the United States.[225]

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[219] *See* BAPCPA § 1405, 119 Stat. at 215 (to be codified at, and amending, 28 U.S.C. § 1104).

[220] *See* BAPCPA § 411, 119 Stat. at 106–07 (to be codified at, and amending, 28 U.S.C. § 1121).

[221] *See* BAPCPA, Pub. L. No. 109-8, § 411, 119 Stat. 23, 106–07 (to be codified at, and amending, 28 U.S.C. § 1121).

[222] *E.g.*, *In re* UAL Corp., No. 02–48191 (ERW) (Bankr. N.D. Ill. 2002); *In re* LTV Steel Co., Inc., No. 00–43866 (WTB) (Bankr. N.D. Ohio 2000); *In re* Johns-Manville Corp., No. 82–11656 (BRL) (Bankr. S.D.N.Y. 1982).

[223] *In re* Owens Corning, No. 00–3837 (JKF) (Bankr. D. Del. 2000).

[224] *In re* Global Crossing Ltd., No. 02–15749 (REG) (Bankr. S.D.N.Y. 2002); *see, e.g.*, Schroeder, *supra* note 202, at A2 (citing Owens Corning Corp.'s operating in bankruptcy since late 2000 as an example of the motivation to speed up business bankruptcies).

[225] *See* Dennis K. Berman, *The Economy: Bush Is Expected to Approve Global Crossing Deal*, WALL ST. J., Sept. 9, 2003, at A2 ("The anticipated White House endorsement should end a 20-month saga for Global Crossing, which filed for Chapter 11 bankruptcy-court protection in early 2002, but has struggled to win U.S. government approval for a plan by Singa-

Notably, based on the year of emergence, the average length of Chapter 11 reorganizations has actually been declining over the last twenty years on the whole.[226] Furthermore, it remains to be seen whether the average length of Chapter 11 cases will decrease because of the new limits on exclusivity extensions. There is the possibility that Chapter 11 cases may take longer, be more litigious, and, consequently, be more expensive as creditors now have less of an incentive to begin working with the debtor immediately. Further, management may delay commencing a Chapter 11 case even longer, leading to increased recidivism. What is clear, however, is that this change to section 1121 of the Bankruptcy Code strengthens the creditors' leverage by giving them the option of being recalcitrant and waiting out the debtor's exclusive periods in order to file their own plan.[227]

V. Does Chapter 11 Remain Relevant?

A. *Going-Concern Value—A Thing of the Past?*

Clearly the concept of comprehensive reorganization as contemplated by the 1978 Act is under intense scrutiny. The well-documented changes to the structure of our economy, including the shift from a manufacturing-oriented economy to a service-oriented one, the growth and globalization of financial markets, and the increasing significance of intangible assets and intellectual capital, to name a few, are significant and real. The current economy thus stands in contrast to the post-Industrial Revolution economy dominated by manufacturing and industry from which the railroad reorganization paradigm emerged, and it challenges the assumptions behind modern-day reorganization.

Professors Baird and Rasmussen are among those at the forefront of the argument predicting the demise of Chapter 11. According to Baird and Rasmussen, structural changes in the U.S. economy over the past twenty-five years, including the shift from a manufacturing economy to a service economy, the spiraling costs associated with the com-

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pore Technologies & Telemedia Pte. Ltd., to take majority control over the Florham Park, N.J., fiber-optic carrier.").

[226] *See Bankruptcy Yearbook, supra* note 2, at 71. From 1982 through 2003, the average length of a Chapter 11 reorganization was 16.5 months. In 2000, 2001, 2002, and 2003, the average length was 14.0, 13.5, 13.8, and 18.2 months, respectively. *Id.* It should be noted, however, that this trend may be a result of the increasing prevalence of bankruptcy sales and the influence of creditors.

[227] *See* BAPCPA, Pub. L. No. 109-8, § 411, 119 Stat. 23, 106–07 (to be codified at, and amending, 28 U.S.C. § 1121).

mencement and prosecution of Chapter 11 cases, as well as other options available to deal with business failure, make Chapter 11 unnecessary and ill-suited for the twenty-first century.[228] Intangible assets now comprise half of the value of non-financial firms in the United States, and firms that see Chapter 11, by their nature, do not tend to have intangible assets of significance.[229] Moreover, the hard assets of firms in a service economy not dominated by industry and manufacturing are fungible assets[230]—general office space, desks, chairs, and word processors.[231] These assets do not retain greater value staying with a debtor, but can be used just as well by other firms.[232] Accordingly:

> To the extent we understand the law of corporate reorganizations as providing a collective forum in which creditors and their common debtor fashion a future for a firm that would otherwise be torn apart by financial distress, we may safely conclude that its era has come to an end.[233]

Are the assets of today's businesses less dedicated than the assets of a railroad? Certainly, the shift to a service economy has meant that capital-intensive, specialized assets, such as steel furnaces and mills, represent a smaller component of today's economy. Indeed, the physical assets of today's economy are office space, desks, and chairs. The conclusion, however, that firms using Chapter 11 today lack going-concern value remains unproven and runs contrary to experience.[234] It is impractical for firms to sell assets as bare as desks or chairs in bankruptcy. Rather, firms sell whole businesses, entities, or divisions in bankruptcy. This fact demonstrates that today's market is rejecting the notion that debtors using Chapter 11 have little or no going-concern value. The integrity of the business as an ongoing operation, rather than as the separate assets, is what results in the enhanced sale prices.[235]

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[228] *See generally* Baird & Rasmussen, *supra* note 9.

[229] *Id.* at 766.

[230] Fungible assets stand in contrast to dedicated or firm-specific assets. "Railroad assets are the archetypal examples of dedicated assets in American bankruptcy law, as individual rails, which together form a track, maintain little value separately, but are far more valuable collectively." Miller & Waisman, *supra* note 22, at 192.

[231] *See* Baird & Rasmussen, *supra* note 9, at 766.

[232] *Id.* at 763–66.

[233] *Id.* at 753.

[234] *Id.* at 788; Miller & Waisman, *supra* note 22, at 191–92.

[235] *See* Miller & Waisman, *supra* note 22, at 192 n.176 (citing *In re* Global Crossing Ltd., 295 B.R. 726 (Bankr. S.D.N.Y. 2003); *In re* Enron Corp., No. 01-16034 (AJG) (Bankr. S.D.N.Y. 2001); *In re* Trans World Airlines, Inc., No. 01-056 (PJW) (Bankr. D. Del. 2001)).

Why do businesses still maintain going-concern value despite the increasingly fungible nature of corporate assets? The answer lies in how assets are conceptualized. Baird and Rasmussen are correct in the sense that fungible assets do not have greater value residing within a particular business.[236] This is only true, however, *when the assets have not yet been deployed.* Businesses incur costs in acquiring, installing, and otherwise deploying assets for use. Similarly, starting a business from scratch is expensive and time-consuming and entails a large degree of entrepreneurial risk. Accordingly, office space, chairs, desks, and word processors, although fungible in the absolute sense, are dedicated in a truer sense.[237]

Stated differently, firms do differentiate between transactions inside the firm and outside the firm. Although, as Baird and Rasmussen note, the ability to conduct business through contracts outside the firm is increasingly common today,[238] the flurry of recent mergers and acquisitions activity and the move toward consolidation across many industries suggest that there are benefits that cannot be obtained by simply contracting with the marketplace. For example, businesses maintain going-concern value as a result of centralized management, overlapping systems, and other benefits of economies of scale. As Baird and Rasmussen admit, transaction costs keep certain activities within the organization: "There is no special magic beyond transaction costs in accounting for any particular collection of assets assembled within a single firm."[239]

In addition, firms have going-concern value even in the absence of transaction costs. Going-concern value is primarily realized through a firm's intangible ability to use its assets more efficiently than its competitors. The conclusion of Baird and Rasmussen that all firms using Chapter 11, by their unsuccessful nature, lack such ability[240] is overly simplistic. Today's firms are often multinational and diversified. A firm may file for Chapter 11 despite having highly profitable lines of busi-

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236 *See* Baird & Rasmussen, *supra* note 9, at 773–75.

237 Professor LoPucki has a similar response to Baird and Rasmussen. He argues that substantial value exists in the relationships of a firm's completely fungible assets. *See* Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's* The End of Bankruptcy, 56 STAN. L. REV. 645, 653 (2003). Both arguments recognize that, in spite of the increased efficiency and competitiveness of the various markets of our economy, transaction costs still exist.

238 Baird & Rasmussen, *supra* note 9, at 770.

239 *Id.* at 754.

240 *Id.* at 763–64.

ness or divisions.[241] A company may be competitive in its industry, yet require Chapter 11 protection for reasons not directly related to the company's competitive position.[242]

B. *Why Chapter 11 Remains Relevant*

As defaulting businesses continue to have going-concern value, Chapter 11 remains relevant to preserving that value, whether through a traditional reorganization or a bankruptcy sale. Chapter 11 has enduring value as a transparent and neutral multiparty forum. It brings all parties in interest to the table to make decisions regarding whether to pursue a reorganization or sale and how to marshal and allocate the proceeds thereafter. As we have stated before, "[t]he automatic stay prevents the 'race to the courthouse' or dismemberment of a debtor's assets prior to adequate consideration of the interests of all parties to the proceeding and a determination as to the appropriate course of action."[243]

Chapter 11 provides a multiparty forum for a debtor to rehabilitate in an orderly fashion under the supervision of the court, to the extent that rehabilitation remains the primary policy goal of the Bankruptcy Code. Anti-Chapter 11 theorists such as Baird and Rasmussen, for example, presuppose that maximization of credit recovery comes ahead of rehabilitation when arguing that Chapter 11 is unnecessary so long as there is a marketplace for the debtor's assets.[244] Inferring from the prevalence of section 363 sales and the

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[241] *See, e.g.*, *In re Trans World Airlines, Inc.*, No. 01–056 (PJW) (certain flight routes of TWA were still highly profitable despite overall losses); *In re Enron Corp.*, No. 01–16034 (AJG) (Enron's trading operations were highly lucrative).

[242] Texaco, for example, commenced Chapter 11 cases in the face of a $10.53 billion judgment to Pennzoil. "When Texaco filed for bankruptcy, no one thought for a moment that the giant oil company would be shut down and its assets scattered to the winds." SKEEL, *supra* note 18, at 1; *see, e.g.*, *In re* Lionel L.L.C., No. 04–17324 (BRL) (Bankr. S.D.N.Y. 2004) (bankruptcy action commenced because of adverse multi-million dollar judgment in trade secrets dispute); *In re* Loral Space & Commc'ns, Inc., No. 03–41710 (RDD) (Bankr. S.D.N.Y. 2003) (bankruptcy action commenced in part to utilize section 363 of the Bankruptcy Code and because of losses stemming from a poor investment); *In re* WorldCom, Inc., No. 02–13533 (AJG) (Bankr. S.D.N.Y. 2002) (bankruptcy action commenced because of fraud allegations); *In re Enron Corp.*, No. 01–16034 (AJG) (same); *In re* Bethlehem Steel Corp., No. 01–15288 (BRL) (Bankr. S.D.N.Y. 2001) (bankruptcy action commenced because of pension liability); *In re* Owens Corning, No. 00–3837 (JKF) (Bankr. D. Del. 2000) (bankruptcy action commenced because of asbestos claims).

[243] Miller & Waisman, *supra* note 22, at 196.

[244] *See* Baird & Rasmussen, *supra* note 9, at 777 ("Even if control rights are not allocated coherently, there is still no need for a collective forum that decides the fate of the firm if the firm can be sold in the marketplace as a going concern."). It should be noted

creditor-in-possession phenomenon of the current Chapter 11 environment that creditor recovery maximization is the primary aim of the Bankruptcy Code is putting the cart before the horse. Immediately after passage of the 1978 Act, it was unequivocal that the Bankruptcy Code's primary policy objective was debtor rehabilitation with attendant preservation of jobs. Although some of the changes that have occurred as to the objectives of Chapter 11 since 1978 are attributable to the special-interest legislation including the Abuse Act, a large degree of the creditor-in-possession phenomenon is the result of creditors' ability to seize control of the process. Rehabilitation remains a predominant, if not *the* predominant, objective of the Bankruptcy Code itself. In this sense, disproportionate creditor control and influence is an argument *for* the strengthening of Chapter 11, not for its dismantling.

Chapter 11 has significant value as a neutral forum. To preserve faith in our economic system and rule of law, any insolvency system must be fair and able to respond to changing economic times and tensions to achieve the objectives of the legislation. Chapter 11 is a process designed to resolve, in a rational, practical manner, conflicts between the debtor, creditors, and other economic stakeholders, as well as conflicts between competing and other creditors who often have diametrically opposed interests. Currently, the Chapter 11 process often is skewed in favor of the controlling creditor(s) at the expense of other parties in interest.

Excessive creditor control remains undesirable because such influence may cause the debtor's operations to be managed solely in the interests of the particular controlling creditor group, thereby foreclosing the debtor's restructuring options. For example, the provisions of a DIP agreement can constrain the debtor's flexibility and take away altogether the option of a possible successful reorganization, leaving a sale as the only viable alternative. One court, recognizing this danger, commented on a financing arrangement:

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that Chapter 11 remains useful when there is no marketplace for assets and thus a traditional reorganization is the only option. Many Chapter 11 cases involve businesses that do not receive significant interest from prospective buyers for their assets. *See, e.g.*, *In re* UAL Corp., No. 02-48191 (ERW) (Bankr. N.D. Ill. 2002) (depressed airline industry); *In re Bethlehem Steel Corp.*, No. 01-15288 (BRL) (companies in heavily depressed industries generally do not receive significant buyer interest); *In re Owens Corning*, No. 00-3837 (JKF) (generally, the successor liability issues of asbestos companies discourage potential interest of prospective buyers); *In re* Chateaugay Corp., No. 86-11270 (BRL) (Bankr. S.D.N.Y. 1986) (environmental liability issues also potentially discourage prospective buyers).

> Under the guise of financing a reorganization, the Bank would disarm the Debtor of all weapons usable against it for the bankruptcy estate's benefit, place the Debtor in bondage working for the Bank, seize control of the reins of reorganization, and steal a march on other creditors in numerous ways. The Financing Agreement would pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit of the Bank and the Debtor's principals who guaranteed its debt.[245]

Chapter 11 is not only a forum for creditors and equity-interest holders to be represented; it also provides a forum for *all stakeholders* to be heard. As discussed above, the need for a bankruptcy law during the railroad failures of the late nineteenth century drew special attention in light of the importance of railroads to the rapidly industrializing economy. Courts overseeing the railroad equity receiverships endeavored to craft a solution that would preserve the functioning of the nation's railroads in light of their importance to parties beyond the railroad's creditors and shareholders. Similarly, the legislative history of the 1978 Act is liberally sprinkled with discussions of the importance of such economic externalities as employees and the public interest.[246]

Chapter 11 provides the debtor and courts the opportunity to weigh public policy considerations and to consider economic externalities. If parties are allowed to secure their own financial security without regard to external costs or benefits of potential transactions, important issues will be neglected in the bankruptcy process (for example, maximization of return to all creditors, continued workforce employment, environmental concerns, equity, and the public interest). The risk that employees would be displaced, firms would be dissolved, and the market would be flooded with workers may increase exponentially. Increased unemployment and contraction of income may have dramatic and far-reaching effects upon a local economy in which the debtor operated.

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[245] *In re* Tenney Vill. Co. Inc., 104 B.R. 562, 568 (Bankr. D.N.H. 1989).

[246] *See* H.R. REP. No. 95-595, at 53–62 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6014–23 (letter from Judge Conrad Cyr responding to congressional request for information about cases with special community impact); H.R. DOC. No. 93-137, at 72 (1973); 124 CONG. REC. 33990 (1978) (statement of Sen. DeConcini). *See generally* Warren, *supra* note 87, at 788 & n.24 (citing 124 CONG. REC. 32392 (1978) (statement of Rep. Edwards)).

Bankruptcy will raise concerns regarding important national issues such as antitrust,[247] national security,[248] public health,[249] and transportation.[250] Opponents of Chapter 11 have failed to address how such public policy concerns can otherwise be adequately addressed. This problem is heightened where public policy claimants have limited interests and little incentive to participate. Accordingly, Chapter 11 provides a forum to foster debate over public policy, the benefits of which might not otherwise be considered.

C. *Why Chapter 11 Remains Relevant to a Sale*

Critics of Chapter 11 argue that a reorganization process is unnecessary as long as there is a marketplace to sell assets.[251] If a buyer is willing to pay a market price for assets, there is no need for a costly rehabilitative process. In turn, creditors benefit because they potentially obtain a greater recovery, one of the fundamental aims of reorganization.

Is the increasing prevalence of section 363 sales desirable? Sales, whether to strategic or financial buyers, arguably are beneficial because they can allow the assets to fetch a fair price, as determined by the market, and transfer the assets to a party better suited to deploy such assets. This argument emphasizes the rights of creditors and the maximization of recoveries and places great reliance on the efficiency of the markets to allocate resources. It is appealing because it posits that the optimal economic decision will be made by an invisible hand when each party simply acts only out of its own self interest.

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[247] Many Chapter 11 cases involving sales require antitrust clearance such as Hart-Scott-Rodino approval. *See, e.g.*, *In re* Allegiance Telecom, Inc., No. 03-13057 (RDD) (Bankr. S.D.N.Y. 2003). Furthermore, a Chapter 11 case, by its nature, can improve an overcrowded industry's health by decreasing capacity, or it can decrease competitiveness in a healthy industry by removing a player from the market.

[248] *See, e.g.*, *In re Global Crossing, Ltd.*, No. 02-40188 (REG); *In re WorldCom, Inc.*, No. 02-13533 (AJG).

[249] *See, e.g.*, *In re* United Healthcare Sys., Inc., No. 97-1159, 1997 WL 176574, at *5 (D.N.J. Mar. 26, 1997) (stating that, in evaluating a sale of assets, a district court must look to the overriding consideration of public health); *In re* Brethren Care of South Bend, Inc., 98 B.R. 927, 934 (Bankr. N.D. Ind. 1989) (stating that, in evaluating the sale of a not-for-profit nursing care facility's assets, the well-being of the residents of the facility is of particular concern).

[250] *See, e.g.*, *In re* US Airways Group, No. 04-13820 (SSM) (Bankr. E.D. Va. 2004); *In re* US Airways Group, No. 02-83984 (SSM) (Bankr. E.D. Va. 2002); *In re* UAL Corp., No. 02 B 48191 (ERW) (Bankr. N.D. Ill. 2002). Like the railroads of the nineteenth and twentieth centuries, air travel has had a profound effect on American society and is a critical part of the economy's infrastructure.

[251] *See, e.g.*, Baird & Rasmussen, *supra* note 9, at 777.

Conversely, critics of the increased occurrences of section 363 sales might question the efficiency of our markets and its ability to allocate resources optimally. They may further argue that the prevalence of sales ignores the rehabilitative intent of the 1978 Act, the transaction costs associated with displacing businesses, and the externalities of bankruptcy. As noted above, rehabilitation is an important policy objective of the Bankruptcy Code, and Congress indicated that consideration was to be given to the impact that a bankruptcy would have, for example, on the community of the debtor.

Undoubtedly, there are compelling arguments in favor of sales in contrast to traditional reorganizations. What is unique and significant about Chapter 11 is that it allows the question to be considered in a meaningful manner. Absent a neutral, multiparty forum, secured lenders will likely exert their influence over a debtor and advocate a sale, as their preference is inherently toward the certainty of recovery that a sale can provide. The benefit of Chapter 11 is the ability to consider both options with input from the debtor, all creditors, and other stakeholders such as employees and the public.

Even if one accepts as a given the benefit of sales and the precept of maximizing creditor recoveries, Chapter 11 remains important. One of the important functions of Chapter 11 is *creating* and *allocating* value among creditors. To this end, there are many instances when the use of the Chapter 11 process to marshal claims properly and to sell assets free and clear of all claims raises the purchase price, a result that cannot easily be achieved outside the Chapter 11 process. This is perhaps one reason that, though troubled companies are not required to use Chapter 11 as a conduit for a sale of their businesses, it is well understood that Chapter 11 provides a market for such a sale and creates a forum for addressing the future of the business and the liquidation of its assets to pay creditors. The creation of such a market is arguably desirable because it allows the assets to fetch a fair price, as determined by the market, and transfers the assets to a party better suited to put such assets to their best use.

Chapter 11 also helps to ensure that value is allocated equitably between creditors of different levels of seniority. For example, in effecting a sale, senior secured creditors may exercise their influence over the debtor's management to sell assets under distortedly conservative valuations, to the detriment of junior creditors.[252] Conversely, although less common, a controlling junior creditor may influence

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[252] Miller et al., *supra* note 157, at 21.

management to overestimate the value of the debtor to increase its likelihood of recovery, which can increase the risk of non-recovery for senior creditors. The wide differences in valuations of assets and the imprecise nature of valuation make this outcome possible.

A study by Stuart Gilson, Edith Hotchkiss, and Richard Ruback suggests that such distortion of valuations may be a common result of creditor control.[253] The nature of creditors' claims as prioritized makes this a natural outcome:

> [A] free-rider problem arises from the obvious fact that the secured party managing collateral sales has no incentive to realize more than the amount of its debt. Anything above that amount must be distributed to other secured parties, the bankruptcy trustee, or the debtor—none of whom bear the costs and risks of the sales.[254]

Creditor-influenced undervaluation of assets has been recognized by the bankruptcy courts. In *In re Exide Technologies*, Judge Carey held that the debtor's plan significantly undervalued the debtor.[255] The financial advisor to the debtor submitted a valuation of between $950 million and $1.05 billion, while the financial advisor to the creditors' committee submitted a valuation of between $1.478 billion and $1.711 billion.[256] Both sides used the same three methodologies—comparable company analysis, comparable transaction analysis, and discounted cash flow.[257] Judge Carey ultimately determined the debtor's valuation to be in the range of $1.4 billion to $1.6 billion.[258] Among other arguments that informed this holding was the argument that controlling senior creditors had influenced the debtor's valuation so as to enhance senior creditor recoveries to the detriment of unsecured creditors.[259]

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[253] Stuart C. Gilson, et al., *Valuation of Bankrupt Firms*, 13 Rev. of Fin. Stud. 43, 45–46 (2000).

[254] *See* Westbrook, *supra* note 188, at 845.

[255] 303 B.R. 48, 66 (Bankr. D. Del. 2003).

[256] *Id.* at 59.

[257] *Id.*

[258] *Id.* at 66.

[259] *Id.* at 58–66. When Exide emerged from bankruptcy in May 2004, the market supported the debtor's proposal, setting an enterprise value and a market capitalization of $1.03 billion and $544 million, respectively. By November 16, 2005, Exide's enterprise value and market capitalization had declined to $788 million and $109 million, respectively. Judge Carey ignored the Supreme Court's admonition that the best way to determine value is by market forces. *See* Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 456–57 (1999) (citation omitted). The debtor's proposed valua-

D. *Contractualism*

The last decade has seen significant debate over privatization of the recovery process or "contractualism."[260] Baird and Rasmussen argue:

> If these [control] rights are allocated sensibly, the shutdown decision will reside in the hands of those with the best information and the appropriate incentives to exercise it correctly. If the transaction costs associated with such contracting are low enough, we once again have no need for a law of corporate reorganizations as traditionally understood.[261]

Although appealing as a solution to the criticism of Chapter 11 process as costly and lengthy, contractualism is not a meaningful alternative to a multiparty, court-supervised forum. It is both undesirable and unworkable.

Contractualism is undesirable because it transforms the problem of the default of a business, a situation affecting a myriad of parties, known and unknown, into a process typically dominated by one party.[262] The contractual model fails to take into account the fact that each party possesses only its own information and its own subjective belief as to what is the "correct" decision. It is precisely these narrow, self-motivated positions that Chapter 11 is designed to test and challenge through an adversarial process. In the real world, decisions are made by the parties that possess control; such parties are not necessarily in a position (or incentivized) to make optimal decisions on behalf of all stakeholders.

Of course, this criticism relates to the more general political and economic debate over the appropriate level of oversight and governmental intervention in our markets, a debate which is beyond the scope of this Article. Perhaps, as a matter of priorities, maximization

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tion took into account market forces—namely, "the price that could be realized for a debtor's assets in a realistic framework, assuming a willing seller and a willing buyer." *In re Exide Techs.*, 303 B.R. at 59. The debtor's expert conducted a "private equity process" where offers were solicited from numerous potential purchasers, including private equity firms and one strategic buyer. *Id.* By contrast, the creditor committee's proposal was a straightforward, formulaic application of valuation methodology without reference to such market forces. *See id.* at 60.

[260] *See* Westbrook, *supra* note 188, at 827–30.

[261] Baird & Rasmussen, *supra* note 9, at 778.

[262] For a detailed discussion of why contractualism is not possible without a dominant secured interest encumbering substantially all of the debtor's assets, see generally Westbrook, *supra* note 188.

of creditor recoveries as an objective of Chapter 11 is more important than rehabilitation of the debtor. Perhaps liquidation is more appropriate in industries suffering from overcapacity. The precise point is that these issues must be considered. Often the discussion of Chapter 11 focuses on rights, particularly the rights of secured creditors, while ignoring the central question of what is trying to be achieved—rehabilitation versus liquidation. In many of these cases, reorganization is quite possible (and may produce a greater recovery to *all* creditors), but the controlling interests of senior creditors push the debtor toward an immediate sale. The Chapter 11 model is desirable because it allows the issue to be considered on a case-by-case basis instead of abdicating these important policy considerations to the free market regime under the assumption that private rights and maximization of recoveries will produce socially optimal outcomes.

Contractualism also fails as an alternative to the Chapter 11 process because it is unworkable. Not only do proponents of this model fail to cite a relevant case where parties efficiently allocated rights among interest holders, they also fail to explain in detail exactly how a debtor can privately contract away the operational decisions of a business between such parties as secured lenders, unsecured creditors, trade creditors, tort claimants, and equity-interest holders. Baird and Rasmussen cite high-tech "startup" corporations, like Webvan, as working models of contractualism.[263] Startups, however, are not useful in demonstrating whether a single collective forum can be displaced by a regime of private contract. By their own admission, startups possess little, if any, debt, so there is no conflict between senior and junior claimants. They are typically controlled by a group of sophisticated equity investors (usually a venture capital fund with experience incubating similar startups) better equipped to make efficient decisions than is the typical shareholder. Unlike the railroads of the nineteenth century, startups do not have fragmented debt interests and equity ownership, but instead tend to have simple capital structures, including only one, if any, class of debt. Railroads, however, carried substantial secured debt, unsecured debt, and equity—all of which were fragmented among numerous parties in interest.[264]

The associated increase in parties in interest in troubled firms and the number of parties that need to be noticed in any particular case make contracting control rights among disputing parties exceed-

[263] Baird & Rasmussen, *supra* note 9, at 781.

[264] *See* SKEEL, *supra* note 18, at 58.

ingly difficult. The ability of any one significant party to hold up the process or generate litigation materially increases the potential that such party can hold up the process or create chaos by attempting to collect before others. Although Baird and Rasmussen argue that control rights can be easily and efficiently allocated, the multiplicity of parties in interest makes it difficult.[265] As a consequence, the "shutdown" decision, as they characterize it, is only a small part of the efficient allocation of control rights. Deciding who should acquire the control rights and be empowered to make the "shutdown" decision in the absence of a dominant secured creditor is very challenging.

E. *Successful Reorganizations*

Amid the increasing number of Chapter 11 cases that result simply in sales[266] and the often-discussed rates of recidivism of debtors,[267] examples of successful, traditional reorganizations still remain.

Federated Department Stores[268] is an example of a highly successful, old-fashioned restructuring. Before its Chapter 11 case, Federated was saddled with $7.5 billion of debt after being purchased in a highly leveraged takeover by Canada's Campeau Corporation in 1988.[269] Its business was declining, and suppliers had lost confidence.[270] Furthermore, while in Chapter 11, Federated was forced to hold a fire sale of

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[265] *See* Baird & Rasmussen, *supra* note 9, at 781.

[266] *See, e.g.*, *In re* AT&T Latin Am. Corp., No. 03–13538 (RAM) (Bankr. S.D. Fla. 2003); *In re* Top-Flite, Inc., No. 03–12003 (MFW) (Bankr. D. Del. 2003); *In re* Budget Group, No. 02–12152 (MFW) (Bankr. D. Del. 2002); *In re* Velocita Corp., No. 02–35895 (DHS) (Bankr. D.N.J. 2002); *In re* Loews Cineplex Entm't Corp., No. 01–40346 (ALG) (Bankr. S.D.N.Y. 2001); *In re Bethlehem Steel Corp.*, No. 01–15288 (BRL); *In re* ANC Rental Corp., No. 01–11200 (MFW) (Bankr. D. Del. 2001); *In re* Polaroid Corp., No. 01–10864 (JPW) (Bankr. D. Del. 2001); *In re Trans World Airlines, Inc.*, No. 01–00056 (PJW).

[267] *See, e.g.*, Edward I. Altman, *Evaluating the Chapter 11 Bankruptcy-Reorganization Process*, 1993 COLUM. BUS. L. REV. 1, 6. When considering the rates of recidivism of debtors, it is important to recognize the role and responsibility of the court. Once a plan is presented, the bankruptcy court is without means to assess independently its feasibility and to overcome the impact of the debtors and creditors who have combined to urge confirmation. Moreover, it is debatable whether, even given such means, courts should impart their own views in an adversarial process when the parties in interest have reached agreement. For a more detailed discussion of the role courts play in recidivism, compare Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231 (2001), with Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987 (2002).

[268] *In re* Federated Dep't Stores, Inc., No. 90–10130 (BP) (Bankr. S.D. Ohio 1990) (emerging in 1992).

[269] Lisa DiCarlo, *Federated's Fashionable Bottom Line*, FORBES.COM, Jan. 24, 2002, http://www.forbes.com/2002/01/24/0124federated.html.

[270] *See id.*

some of its key assets, including buildings.[271] Despite these problems, Federated was able to use Chapter 11 to restructure.[272] Federated reached a deal to swap $5 billion in debt and other liabilities for new notes and equity, allowing it to emerge triumphantly from bankruptcy protection.[273] In Federated's first fiscal quarter after emergence, the company recorded an $11.8 million profit.[274] In 1994, Federated acquired its archrival, Macy's, pursuant to Macy's Chapter 11 plan of reorganization.[275] By 1998, Federated's debt was rated as "investment" grade by the major rating agencies.[276]

Similarly, Zales International Corporation,[277] the famous jewelry retailer, is another example of a traditional restructuring. While in Chapter 11, Zales evaluated and refocused its business strategy, expanding merchandise selection and improving merchandise quality.[278] Since emergence, Zales has improved sales, expanded store openings, and put itself in a position to compete for market leadership in its industry.[279] WorldCom, Inc.[280] is yet another example. After having shed $36 billion in debt and retaining an enviable business customer list, WorldCom emerged from Chapter 11 protection, renamed as MCI, with $6 billion in cash, to the chagrin of competitors fearful of a price war.[281] Notably, earlier this year, MCI was the target of a fierce takeover battle between Verizon and Qwest.[282]

These examples are not intended to be empirical illustrations that traditional reorganizations remain a significant part of Chapter 11. Instead, they are meant to demonstrate that, if Chapter 11 is used proactively and with rehabilitation in mind, it can be an effective tool for turning around failing businesses. Of course, not all businesses can be turned around because many that resort to Chapter 11 are be-

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[271] *Id.*

[272] *See id.*

[273] *Id.*

[274] DiCarlo, *supra* note 269.

[275] *Id.*

[276] *Id.*

[277] *In re* Zales Int'l Corp., No. 92-30707 (SAF) (Bankr. N.D. Tex. 1992) (emerging in 1993).

[278] *See* Elaine De Simone, *Zales Jewelers Make Dazzling Recovery*, RETAIL TRAFFIC, Nov. 1, 1998, http://retailtrafficmag.com/mag/retail_zales_jewelers_makes/index.html.

[279] *See id.*; *see also* Robert Hurtado, *The Rise in the Stock of Zales, the National Jewelry Chain, Has Shown There is Life After Bankruptcy*, N.Y. TIMES, May 2, 1996, at D12.

[280] *In re WorldCom, Inc.*, No. 02-13533 (AJG) (emerging in 2004).

[281] *See* MCI Emerges from Bankruptcy, CNN/MONEY, Apr. 20, 2004, http://money.cnn.com/2004/04/20/technology/mci_bankruptcy/.

[282] *See, e.g.*, Dionne Searcey, *Protest by MCI Shareholders May Push Qwest to Rejoin Battle*, WALL ST. J., May 16, 2005, at B4.

yond redemption. There is no solution for the lack of a viable business model. Similarly, businesses cannot be turned around to the extent they delay too long in seeking Chapter 11 relief or to the extent their operations are effectively constrained by creditors. The danger here is the potential that arguments of the demise of Chapter 11 based on the lack of reorganizations in the traditional sense or the high degree of recidivism will become self-fulfilling prophecies.

To encourage reorganization, it is imperative that Chapter 11 be restored as a more neutral forum that gives the debtor and all parties in interest a meaningful ability to reorganize. This imperative seems greater than ever given the increasing power and influence of creditors. Unfortunately, at this time, much of the criticism of the Chapter 11 process appears aimed squarely at the debtor. In that respect, there is a perception that the current length and cost of Chapter 11 cases is the fault of the intransigent debtor. The present course of action of further handicapping the debtor may lead only to more recidivism and fire sales, an unwelcome result. It is not even clear that, under this current creditor-in-possession regime, all creditors, as opposed to senior secured creditors only, do better. The Chapter 11 process requires a reassessment of which parties are currently at the helm, and which parties *should* be:

> The reason that control of the process of recovery has become so important is that [going concern sales or financial restructurings] often require more time and more complex management, both operational and financial, than a simple piecemeal liquidation. At the same time, the range of possible values, from a low value in a simple liquidation to a high value obtained from a creative merger, has become much greater as well. Closely related is the fact that key decisions in this more complex environment turn importantly upon evaluation of risk and a willingness to accept risk.[283]

Interestingly, the evolution of the reorganization model in the United States is moving opposite to the European model, which is taking a form similar to the Chapter 11 model that prevailed from 1979 through the end of the twentieth century.[284] The United Kingdom's recently enacted insolvency law is a particularly useful example for

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[283] Westbrook, *supra* note 188, at 804–05.

[284] *See* SKEEL, *supra* note 18, at 238–43.

purposes of contrast.[285] It abolished a long-standing system of secured contractualism.[286] The overhaul was designed to reduce the impact of one party over the process. According to Professor Jay Westbrook:

> [N]eutrality is a necessary concept in any system for managing a general default in which the policymaker provides for multiple beneficiaries and charges the manager with maximizing value for all of them. A dominant secured party cannot be a neutral manager, and its management creates a serious potential of loss for other beneficiaries.[287]

Conclusion

Bankruptcy law in the United States has evolved significantly over the last century. The twenty-five years following the enactment of the 1978 Act, the changes that the reorganization world currently is undergoing, and the enactment of the Abuse Act raise the question as to whether it has come full circle. Many of today's changes go to the core of the whole concept and objective of Chapter 11 and are reminiscent of the atmosphere behind the Chandler Act. Chapter X of the Chandler Act, although comprehensive and well-intentioned, failed to encourage reorganization because it was structurally inefficient and perhaps overly complex, thereby requiring the expenditure of excessive time and money. At a time when the concept of reorganization remains relevant, there is a danger of repeating the mistake of discouraging distressed companies from pursuing rehabilitation as originally contemplated by the 1978 Act, a policy goal that seems to have diminished. Despite the contractions of the debtor protections that were provided for in the 1978 Act, there is still a need to provide distressed debtors a reasonable opportunity to rehabilitate themselves for the benefit of all stakeholders and interests and not just a group of sophisticated, aggressive lenders and speculative investors. The economy remains credit-intensive, and there must be relief from oppressive debt that can be provided only by a fair and reasonable reorganization law.

Many of the arguments underlying the assertion of Chapter 11's demise actually demonstrate the opposite—that there is a need for a reinvigorated, rehabilitation-oriented process. The criticisms of Chapter 11 often focus on the fact that the benefits of Chapter 11 do not

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[285] *See id.*; Westbrook, *supra* note 188, at 852–55.

[286] *See* Skeel, *supra* note 18, at 238–43; Westbrook, *supra* note 188, at 852–55.

[287] Westbrook, *supra* note 188, at 852 (citation omitted).

justify its costs, particularly those of professionals' fees.[288] This concern is not a novel one[289] and appears to stem from the high proportion of professionals' fees in recent fraud cases.[290] Given this concern, perhaps the more relevant question going forward is whether Chapter 11 should be based on an adversarial process. The American legal and political system is rooted in the adversarial process and the notion of competing parties or factions, but such systems, by their nature, generate considerable litigation and expense. Do the costs of the Chapter 11 process outweigh its benefits? Does the adversarial process remain relevant? These questions must be asked and answered as long as there is a continuing need for reorganization and rehabilitation.

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[288] *E.g.*, Michael Arndt & Aaron Bernstein, *For UAL, Going Broke Isn't Cheap*, BUS. WK. ONLINE, Mar. 25, 2005, http://www.businessweek.com/bwdaily/dnflash/mar2005/nf20050325_3016_db016.htm ("It takes a lot of money to get through a bankruptcy.").

[289] *See, e.g.*, *In re* Drexel Burnham Lambert Group, Inc., 133 B.R. 13, 26 (Bankr. S.D.N.Y. 1991) ("[W]e have been left with the strong impression that for [financial advisors and investment bankers] the debtor is the cash cow to be milked, Chapter 11 the milking parlor, and the Judge the milking stool."). Likewise, as discussed above, critics of the railroad receiverships complained that bankers and attorneys received substantial fees before anyone else was paid. *See* SKEEL, *supra* note 18, at 68.

[290] Professor Lynn LoPucki has compiled a list of the top ten costliest bankruptcy proceedings. The top two (Enron and WorldCom) are fraud cases, and Adelphia Communications (#6) and Global Crossing (#9) also make the list. *See* Arndt & Bernstein, *supra* note 288. Fraud cases, by their nature, likely generate more professional fees than the average bankruptcy case. In particular, significant legal and accounting fees are incurred by investigating and unraveling the fraud that caused the company to seek Chapter 11 protection. These fees often include the deployment or retention of numerous additional professionals to address the additional issues raised by the fraud, including the involvement of additional regulatory agencies and litigating parties.